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THE EVOLUTION OF THE INDIAN INCOME TAX

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PREFACE

THE object of the present volume is to trace the history of income tax in India from 1860 onwards, to study the existing system and to offer some criticisms derived from a comparative study of British and Indian income tax laws. So far as the present writer is aware, no comprehensive and critical account of the Indian income tax has previously been written. The reasons for this lack of interest in the subject are not far to seek. Income tax, until very recent times, has had an uneventful career. No acute political controversies, such as marked the vicissitudes of the customs revenue in India in the 'seventies and the 'eighties of the last century, nor such subtle theoretical discussions as have attended the chequered career of the Indian land revenue, have disturbed the even tenor of its life. Then, again, until the outbreak of the last European War, income tax occupied an unimportant place in Indian budgets.

The changes brought about by the war have now given this source of revenue a much more important position in the Indian fiscal system. It is, therefore, fitting that the tax should be subjected to a critical examination. We need to study the considerations which from time to time impelled the Government of India to effect changes either in the scope of the tax or in the methods and machinery of its assessment. We need also to explore the possibilities of removing inequalities and of increasing the yield of the tax in the future, without inflicting injustice or hardship on the tax-payers.

In the preparation of this volume the writer has utilized the records and papers available in the India Office and also in the British Museum. He desires to acknowledge with gratitude the many helpful suggestions which he has received from Dr. Hugh Dalton, now Parliamentary Under-Secretary for Foreign Affairs, and Dr. Gilbert Slater. It must be added that neither of these gentlemen is responsible for the views expressed or for the statements made, for which the writer takes full responsibility.

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London School of Economics
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CHAPTER I

INTRODUCTORY

INCOME tax has now come to be regarded as a necessary feature of any well-arranged scheme of finance. It is now realized that the rôle of this tax is to correct the inequalities of a revenue system which relies exclusively or predominantly on the taxation of the common necessaries of life. Taxation of these commodities which are universally consumed is regressive in character, as the proportion of income spent on them declines as we ascend higher up the scale of income. A revenue system which includes many regressive taxes of this character, must also have some sharply progressive ones to maintain the balance and introduce an element of progression; and the taxes that are generally resorted to for this purpose are an income tax and an inheritance tax.

From this point of view it is a matter of perfect indifference to a community which one of those taxes is imposed. Yet there are other considerations of a far-reaching character, which point to the imperative necessity of an income tax in order to adjust properly the burden of taxation in a country. A tax system which has any claim to be considered as equitable and fair should pay regard to the domestic circumstances of the tax-payer, and also introduce an element of differentiation as between income derived from property and investment on the one hand and that derived from personal exertions on the other. Regarded

in this light an income tax is perhaps an essential instrument in the hands of a Finance Minister.

While theoretic considerations point to the paramount necessity of an income tax in the revenue system of any well-ordered State, it is curious to find this tax adopted in many countries only in comparatively recent times. In Germany, for instance, in its modern form income tax dates only from the year 1891. In the U.S.A. the Federal income tax dates from the year 1913. The American Constitution laid down that no direct tax should be levied unless it was apportioned among the States in proportion to population and was uniform. The Supreme Court declared the Federal income tax of 1894 "unconstitutional," inasmuch as being a direct tax it was not apportioned in accordance with the terms of the Constitution. It was only when the Constitution was amended in 1913 that it became possible to levy a Federal income tax in the U.S.A. A comprehensive income tax was placed on the statute book in France only in July, 1914.

The position in Great Britain and India presents an interesting contrast to that in other countries. In Great Britain income tax had its origin in 1798 in the financial necessity caused by the war with France. It was repealed in 1816 with the advent of peace. For the next quarter of a century the tax remained an unused instrument till it was revived by Sir Robert Peel in 1842. Since then it has passed into a permanent feature of British budgets and has occupied a place of ever-increasing importance. In India the tax had its origin in the deficit in revenue caused by the outbreak of the Sepoy Mutiny of 1857. It was imposed for the first time in 1860, and was largely based on the then existing English tax with its separate schedules. An elaborate Act was passed comprising several parts and over two hundred sections. After a brief experiment lasting for a period of five years, the tax was abandoned in favour of other direct taxes each having its distinctive appellation. The income tax was revived during 1869–73 to be abandoned once again. As a permanent feature of Indian budgets it dates from 1886 when the exigencies of

finance necessitated its reimposition. Since then, like its British prototype, it has become a regular feature of the tax system of the country, and, although by no means comparable to the British income tax as an engine of finance, it has steadily become a more important feature in the budget.

The history of Indian income tax may conveniently be divided into three well-marked periods. The first period dates from 1860 and ends with 1885. This was the period of trial and error. During this time income tax was twice adopted and twice abandoned. India also experimented with three other direct taxes closely akin to an income tax, known twice as licence tax and once as certificate tax. The characteristic feature of this period is the vacillation of the Government in their efforts to adjust the burden of taxation as between the landed interests, the fundholders and the trading and professional classes. Each one of these classes becomes the target of attack on different occasions, and the impression which the history of this period leaves on the mind of a detached observer is that the Government were not guided by any definite, rational or consistent principle. The fundholder is once singled out for taxation to be told a few years later that he could not be taxed without the Government being charged with breach of faith. The income from land is brought under taxation for a few years, and then suddenly the Government discover either that the Permanent Settlement of land revenue stands in the way of taxation of agricultural income in Bengal, or that the land revenue is so heavy in other Provinces as to be oppressive. The fact is that during this period the Government were for the first time feeling their way through a dark and complicated labyrinth, with no light in the shape of past experience to guide them.

The second period, which may be called the period of consolidation, ranges from 1886 to 1914. The beginning of this period saw the main lines of policy definitely fixed, and the efforts of the Government were directed in the main towards setting up an adequate machinery for the work of assessment. Minor alterations were made from

time to time, but the general features of the tax remained unchanged till after the declaration of the European War, when financial necessity brought about extensive changes of an important character bringing the Indian income tax into line with its prototype in Great Britain in several respects.

The reform of income tax during and after the war has been swift, sudden, and extensive. The introduction of graduation, the insistence on returns from assessees, the inclusion within the scope of the tax of certain categories of income which had hitherto escaped taxation, the elaboration of the rules relating to depreciation of plant and machinery—these and a number of other reforms came in quick succession, all of them having their share in transforming the old and comparatively simple structure into a financial instrument of great complexity. During this period the enactments on income tax became so numerous and the changes inaugurated by them so varied in character, that the Government found it necessary to repeal all previous enactments and codify the law on the subject in one single statute, namely, Act XI of 1922. Since this codification at least half a dozen other amendments have been made, and it will not be long before the need for a fresh consolidating Act will arise.

Income tax to-day forms a growing source of revenue in India. Its importance has been increasing both absolutely as well as relatively to other sources. In 1891–2 the tax yielded 1·6 crores, in 1901–2 2 crores, in 1914–15 3 crores of rupees. By 1918–19 the receipts had mounted to 11 crores, and in 1921–2 to the highest point hitherto, 22 crores of rupees. In 1891–2 income tax furnished 1·7 per cent. of the total revenues of India, in 1914–15 2·4 per cent., in 1921–2 about 11 per cent., and it is a safe prophecy to make that direct taxes will come to occupy a place of yet greater importance in the national economy of India.

One of the outstanding features of recent financial developments in India has been the adoption of a policy of "discriminating protection." It may be taken for granted that having once adopted the principle, the Government would

be led to yield to the daily growing clamour for protection to nascent industries. The importance of income tax in this reoriented fiscal system is not likely to be less than at present; for income tax will be called upon to exercise a compensatory effect in view of the disproportionately heavy burdens imposed upon the poor on the one hand and on agriculture on the other, by a system of protective duties.[1] Nor must we shut our eyes to the constitutional changes that have already been inaugurated or to the reforms that are yet to come. It is a matter of common experience that the transference of political power to the masses is accompanied by a demand for measures for ameliorating the condition of the newly enfranchised people. The demand for State action in regard to compulsory elementary education, public health and in other spheres is likely to grow apace in the Provinces; it is probable that as a result the near future will see in India an extension and an increase of the income tax and the introduction of a graduated scale of death duties. That the Provinces cannot any longer be deprived of a substantial share in the proceeds of the income tax is now generally admitted.[2] The question of the allocation of the resources between the Government of India and the Provincial Governments is under consideration by the Indian Statutory Commission, and it is expected that a scheme of division acceptable alike to the Provinces and to the Government of India will emerge out of their deliberations.

Whatever may be the immediate future of death duties, no one will deny that the Indian income tax might be made a more powerful instrument of revenue than it is at present, by a tightening of the administration, by suitable adjustment in the rates and by bringing within its scope certain categories of income that at present escape taxation altogether. These and certain other suggested changes will be considered in the following pages.

[1] See Gyan Chand: "The Function of Income Tax in the Fiscal System of India"—*Indian Journal of Economics*, April, 1925.

[2] Debates in the *Indian Legislative Assembly*, 12th March, 1928.

CHAPTER II

THE SEPOY MUTINY AND INDIAN FINANCE

THE Indian income tax is the child of financial necessity. It was one of the measures introduced by Mr. James Wilson,[1] India's first Finance Member, to make good the deficit in the revenue caused by the Sepoy Mutiny of 1857.

s of the Eve of the Mutiny.

The revenue system of the country as it stood on the eve of the Mutiny was singularly inelastic. By far the largest item of public income consisted of land revenue, regarding whose nature and origin there existed then and there exists now a great controversy. Out of total receipts amounting to a little over £33 millions in 1856–7, land revenue alone contributed a sum of £17½ millions which obviously, under various systems of permanent settlement, settlement for thirty years and only in a few cases for twenty years could only increase very gradually from year to year. Next to land revenue, the receipts from opium contributed the largest single item, yielding a sum which varied between 4 to 5 million pounds. This also was a very inelastic source of income. Salt and customs duties contributed a sum of a little over £2 millions each. The revenue from salt was derived either from the imposition of an excise duty as in the Bombay Presidency, or from a monopoly of a qualified

[1] James Wilson (1805–60). At the age of 16 he was apprenticed to a hat manufacturer at Hawick. In 1844 he retired from business. But before his retirement he had published three works: (i) *Influence of Corn Laws as Affecting all Classes of the Community*, (ii) *Fluctuations of Currency, Commerce and Manufactures*, (iii) *The Revenue, or what shall the Chancellor do?* He founded the *Economist* in 1843. In 1859 he was appointed Vice-President of the Board of Trade and Paymaster-General. In the same year he accepted the position of Finance Member in India. He died in Calcutta on the 11th August, 1860.

nature as in other parts of the country. The customs revenue was derived mainly from the small minority of European residents, the standard of living of the bulk of the population having been too low to permit of the consumption of imported luxuries to a large extent. The balance of the revenue was made up of small items like *abkari* or revenue from the sale of intoxicants, receipts from Post Office and those from the Courts.

In addition to these taxes which constituted the main sources of revenue before the outbreak of the Mutiny, a considerable amount of public revenue used to be collected from internal taxes on trade, on income and professions. Internal transit duties were almost universal throughout British India right up to 1834–6. The British Government had inherited the system of levying taxes on trade from the early native chiefs. Every petty chief whose territory lay in one of the great lines of communication used his power to levy inland or transit duties on goods passing across his domain. Every little *Zemindar* constituted himself into a tax gatherer and made use of his position to extort the largest possible amount the trader could be induced to pay.[1] This system was continued for some time by the servants of the East India Company in nearly every Province or district, till at last the exaggerations of this system roused them to a sense of their responsibility.

Taxes on Trades and Income.

Inland and transit duties disappeared from Bengal during the days of Lord Cornwallis. They were reimposed in a modified form in 1801 and finally abolished in 1836. Bombay discarded these taxes in 1837 and Madras in 1844. But though the transit duties disappeared from the British territories by 1844, another ancient tax still lingered in the Madras Presidency even as late as 1860. This was the *Mohturfa*, or a tax on professions and houses. The Court of Directors had ordered the abolition of this tax in November, 1856, but it was not found practicable to give effect to that order. In a minute of the 10th

[1] Memorandum of Improvements in Administration during last thirty years—*House of Commons papers*, 1857–8, XLIII, pp. 1–38.

June, 1859, Sir Charles Trevelyan,[1] Governor of Madras, observed :

> "The inhabitants of this Presidency have already been hardly dealt with, by the retention to this day of that most objectionable system of native taxation known by the name of *Mohturfa*, although it was to have been abolished a quarter of a century ago with the transit and town duties of Upper India, and it is believed in England that it was abolished long ago and credit has been repeatedly taken by members of the Home Government for its abolition."

Trevelyan condemned this tax in unmeasured terms, as it had a tendency to sap the springs of industry by mulcting the poorest of the people and because it exercised an inquisitorial interference with business of every kind. It is necessary at this stage to consider this tax in some detail, as the germs of the Indian income tax are to be found in the *Mohturfa* and *Veesabuddy* prevalent in the Madras Presidency from the very beginning of the British rule in India.

The *Mohturfa* in Madras.

The *Mohturfa* was a tax upon the profits of persons exercising manual arts or professions, e.g., weavers, cotton cleaners, braziers, goldsmiths, ironsmiths, and carpenters, while the *Veesabuddy* was a tax upon the profits of trade.[2] Although called a profession tax, the *Mohturfa* was really a rough income tax. For instance, though nominally assessed on the weaver's loom, it was really based upon a review of the individual circumstances of the weaver. The circumstances of the weaver's family, the number of days the weaver worked, the number of children helping him in his work—all these determined the amount of assessment.

[1] Sir Charles Edward Trevelyan (1807–86), Governor of Madras. He entered the service of the East India Company as a writer in 1826. He married the sister of Lord Macaulay in 1834. The publication of his Minute on the Inland Customs and Town Duties exposed the iniquities of these taxes and led to their abolition. In 1840 he became Assistant Secretary to the Treasury and occupied that post for nearly nineteen years. In 1859 on the resignation of Lord Harris he became Governor of Madras. He was recalled from that office in 1860 on account of his public protest against the imposition of income tax. In 1862 he again went out to India as Finance Member and distinguished himself by his administrative reform and by the development of extensive public works. He returned to England in 1865.

[2] *Vide* section II, *Regulation IV* (Madras) of 1818.

It often happened that a weaver found himself saddled with higher taxes simply because he had turned out one or two pieces of cloth more than his usual output, though the number of looms in his possession had not increased.[1] The payment of this tax was governed by Regulation V of 1832 (Madras). Section II of this Regulation declared that the tax was payable by all persons exercising arts, trades or professions which, according to the custom of the country, had hitherto rendered persons exercising such arts, trades or professions liable to that tax. It was collected with land revenue, and the procedure for collection and the penalties for non-payment were identical in both cases.[2]

The *Veesabuddy* in the Ceded Districts.

The *Veesabuddy*, like the *Mohturfa*, was also collected with land revenue, but a separation between the two sources of revenue was effected for the first time by Regulation IV of 1818 in the Ceded Districts of Bellary and Cuddappah.[3] The *Veesabuddy* differed in material respects from the *Mohturfa*. Apart from the fact that while the one was a tax on manual labour and the other a tax on trade, there was a fundamental difference between the two taxes as regards the manner of assessment. The *Mohturfa* was based upon individual assessment, while the *Veesabuddy* followed the principle of aggregate assessment. To use the language familiar to modern students of public finance, the *Mohturfa* was a non-apportioned or a rated tax, while the *Veesabuddy* was an "apportioned" tax. For the purpose of assessing the *Veesabuddy*, the aggregate income of the merchants of a district or *talook* was calculated from an account of imports and exports, population, produce, consumption and profits of trade. The quota for each district or *talook* was then fixed at the rate of 15 per cent. of the aggregate income thus arrived at. The tax was then distributed amongst the contributors by the merchants themselves on the basis of a knowledge of individual gains.

Regulation IV of 1818 preserved intact the main features

[1] See Rickards, *India*, Vol. I, p. 501.
[2] Section III, *Regulation V* (Madras) of 1832.
[3] Preamble to *Regulation IV* (Madras) of 1818.

of this tax. It only laid down in detail the mode of apportionment, provided for the appointment of Referees to settle disputes amongst the contributors and indicated the conditions under which appeals were to be lodged to the Collector and the Board of Revenue. Under the provisions of section VII (1) of Regulation IV of 1818 all disputes amongst the contributors regarding the shares to be assessed on individuals were to be decided by Referees or arbitrators, not more than eight nor less than four in number, of whom one-half was to be nominated by the party disputing the correctness of the amount assessed on him, and the other half by the second party concerned in the reference. The *Tahshildar* was required to nominate one more Referee in case the votes were equally divided.[1] After the shares payable by individual assessees were decided upon, the principal merchant of each village was required to prepare a general statement showing the total amount payable. Regulation IV of 1818 introduced one little modification with a view to reduce the burden of the tax. Under section III (2) the aggregate assessment was reduced from 15 to 10 per cent. of the income of the whole body of contributors. The assessment once made held good for a period of five years, although there was nothing to prevent the Government from lowering it.[2] The yield of the *Mohturfa* and *Veesabuddy* in 1857–8 and 1858–9 was as follows :

	Rs.
1857–8	1,051,534 [3]
1858–9	1,103,253

Ever since 1844 the question of the abolition or modification of these two taxes had been the subject of discussion between the Governments of India and Madras on the one hand and the Court of Directors on the other. In 1848 Mr. Daniel Elliot, a senior officer of the Madras Government,

[1] Strictly speaking, the *Tahshildar* was required to nominate three more Referees. Each of the parties had the right to challenge one person, leaving the third one to act as umpire.

[2] Section III (2), *Regulation IV* (Madras) of 1818.

[3] *Vide* Trevelyan's Minute, December 1, 1859, on Harington's Licensing Bill, *H. of C. papers*, 1860, Vol. XLIX, pp. 297–305.

suggested a suitable modification, with a view to remove some of the disagreeable features of these taxes. In a subsequent minute, however, he changed his mind and pressed for their entire abolition. Lord Dalhousie admitted the evils associated with the administration of these taxes, but refused to give up the revenue involved in view of the pressing financial necessity. Mr. Dorin, one of the members of the Governor-General's Council, agreed with Lord Dalhousie; but three other members—Mr. Grant, Sir Barnes Peacock and General Anson—pronounced in favour of their immediate abolition. The Court of Directors agreed with this latter view, and in a despatch dated the 5th November, 1856, ordered the repeal of the taxes.[1] They observed:

> "They (the taxes) are confined to one Presidency, which is subject to at least as heavy a pressure of taxation as any other part of India. . . . They are most unequally distributed over the districts subject to them, four only of the twenty collectorates into which the Presidency is divided, contributing upwards of half the total amount. The assessment is arbitrary, irregular and undefined, resting (except as regards the *Veesabuddy* of the Ceded Districts) on no law but merely on ancient usage. . . ."

Taxes on trades and professions were not by any means confined only to the Madras Presidency. In other parts of India, direct taxes of various denominations formed a regular feature of the financial system of the native States long before the advent of the British. Elphinstone, in his Report on the Peshwa's Dominions (1819), gives an account of the direct taxes levied by the Mahrattas. Some of these taxes were confined only to traders. In addition to the *Mohturfa* there were various other taxes each having its own distinctive appellation. There was a tax on village headmen, on carpenters, on blacksmiths, and on other village artisans called by the name of *Belotee*, a house tax, a tax for the right to beat a drum. These taxes for the most part disappeared under British rule, as they were unequally assessed, objectionable in principle and difficult to reform. In the Central Provinces, however, a remnant of these taxes

[1] Despatch No. 17 from the Court of Directors to the Governor-General in Council, Rev. Department, dated the 5th November, 1856—*H. of C. papers*, 1857, Vol. XXIX, pp. 412–13.

survived and was allowed to continue by the British administrators. It was called the *Pandhari*—a tax dating from the Mahratta times. It was supposed to be a house tax, but in fact it resembled a tax on trades and professions.

The Effects of the Mutiny.

Such was the structure of the Indian revenue system, when the Sepoy Mutiny made its influence felt. The rising was successfully quelled, but it became clear to all the world that the Government of India had become virtually bankrupt. On the eve of the Mutiny revenue and expenditure practically balanced. In 1856–7 the revenue amounted to £33·3 millions, and expenditure exceeded the revenue by only a small margin. India's public debt was estimated at £59·4 millions and the interest charge at £2·5 millions. The army cost to the country a little over £11 millions.

The immediate effect of the Mutiny was an increase in military expenditure. The Government were forced to increase the strength of the army, particularly of the European section, included in it. The composition of the troops before the Mutiny was as follows:

Europeans	45,522
Indians	249,153
Total	294,675

After the outbreak had been quelled the total strength of the army in India stood at 318,085, distributed as follows:

Europeans	110,320
Indians	207,765
Total	318,085

In addition to the personnel in the regular army, there was created a new police force, militarily organized, numbering 89,289, thus giving a total force of 407,374.[1] The effect of the increased employment of European military force was clearly reflected in India's military budget. It was estimated at the time that the cost of employing a European

[1] See Sir Charles Wood's statement in the House of Commons, 1st August, 1859.

soldier was at least four times as great as that of an Indian soldier,[1] and some calculation even suggested that the proportion was nearer five to one than four to one. India's military expenditure nearly doubled itself in two years. This will be evident from the following figures showing India's military expenditure, exclusive of the amount spent on military buildings.[2]

Year.	Military Expenditure.
	£
1856–7	11,491,905
1857–8	15,659,925
1858–9	21,080,948

The existing resources of the Government of India were utterly inadequate to meet the heavy strain imposed upon them. The year 1857–8 closed with a deficit of nearly £8 millions, followed next year by a still greater deficit of over £13 millions. The normal method of meeting these deficits was by a constant recourse to loans both in India and in England. During the two years 1857–8 and 1858–9 a sum of £10·5 millions was borrowed in India, whilst the sum borrowed in England during the same period amounted to £11·5 millions. India's public debt, which stood at a little over £59 millions on the eve of the Mutiny, rose to £81·5 millions, and the debt charge showed a corresponding increase from £2·5 to £3·5 millions.[3]

The situation looked much more critical when, in August, 1859, Sir Charles Wood announced in the House of Commons that the year 1859–60 was again likely to end in a deficit of nearly £10·3 millions, even though the revenues had been augmented to a considerable extent by the increase of customs and opium duties. Including these two items, the revenues of India were estimated at £35·8 millions and the expenditure at £46·1 millions, thus leaving a deficit of £10·3 millions. It became clear that a chronic deficit of such

[1] *Vide* letter from the Government of India, Home Department—(Revenue No. 11 of 1860) to Sir Charles Wood.

[2] *Vide* Enclosures to Financial Letter to India, No. 136, dated the 22nd August, 1860.

[3] *Vide* Sir Charles Wood's statement in the House of Commons, 1st August, 1859.

magnitude should not be allowed to persist for an unwarrantably long period and that heroic measures were needed to meet the situation.

It was in a situation practically bordering on bankruptcy that the Indian Government were forced to look to alternative sources of revenue, and Sir Charles Wood announced in the House of Commons that the Government of India had expressed their intention of considering the feasibility of imposing new taxes in India. The suggestions which were put forward were three in number, viz., a stamp duty, a succession duty and a duty on licensing of trades and professions. The first two proposals did not take any tangible shape at the time; the third proposal was embodied in a bill that proved abortive. A bill for licensing of trades and professions was introduced in the Indian Legislative Council by Mr. Harington on the 13th August, 1859. But before the measure could be enacted, Mr. Wilson, who was sent out to India as Finance Member, advised that the measure should be dropped. It is nevertheless interesting to discuss Mr. Harington's proposal in some detail, as it represents the first definite attempt on the part of the early British administrators to impose something like an income tax on a uniform basis throughout British India. It is difficult to state with whom the idea first originated, but it is interesting to note that the proposal for an income tax gradually emerged during the discussion that took place on the future of the *Mohturfa* in the Madras Presidency. It was at that time that the suggestion was put forward that the *Mohturfa* might be so regulated as to convert it into a house tax or an income tax or into both combined, and that such a tax might be found unavoidable as a measure of financial necessity throughout India.[1]

Taxation Proposals.

[1] See despatch No. 17 from the Court of Directors to the G.G. of India, Revenue Department, 5th November, 1856, *H. of C. papers*, 1857, Vol. XXIX, pp. 412–13.

CHAPTER III

WILSON'S INCOME TAX, 1860–5

IN view of the existence of taxes on trades and professions in different parts of India, it is perfectly natural that the first attempt of the Government of India should have been directed towards the imposition of a licence tax on an all-India basis. This attempt proved futile, but it shows that the Government of the day were trying to adopt the path of least resistance in their efforts at financial reform.

Harington's Bill for Licensing of Trades and Professions.

Under the bill for licensing of trades and professions introduced in August, 1859, by Mr. Harington, every person, company, or association, carrying on business and having an income of Rs.5½ a month or more was liable to take out a licence. The assessees were originally divided into ten classes. The highest sum of Rs.2,000 was payable by any person or corporation carrying on business as a banker. The minimum licensing fee was fixed at Rs. 2, while persons in intermediate grades were divided into eight different classes paying 1,000, 500, 250, 100, 50, 25, 10, and 5 rupees respectively according to their incomes. In trades, *choudhuries* were to be appointed [1] at the request of the Collector to assist in giving effect to the provisions of the measure. It was proposed [2] that all Government servants, workmen for hire, as well as *ryots* and cultivators of land should be exempted from the operation of this tax.

Such were the proposals incorporated in the draft bill. But it encountered serious opposition during the second reading, and it emerged from it considerably modified and

[1] Section XI of the draft bill.
[2] Section XXI and XXXI of the draft bill.

enlarged. The provision of the bill which laid down that the highest sum of Rs.2,000 was to be paid only by bankers, was opposed, amongst others, by Sir Barnes Peacock, who remarked, " Why should this dead set be made against bankers ? " It was true that many native *mahajans* made large profits and contributed nothing to the taxes of the country. But this was not a reason for taxing them in a proportion higher than other trades.[1] The result of this opposition was that the distinction between the profits of bankers and those of other trades was abolished, and all trades were placed on the same footing.

As the bill had divided the assessees into ten classes only, it became clear that considerable inequality in taxation would result from its operation. This objection was met by the creation of seven more classes. A clause was also added that the tax should, as nearly as possible, amount to 3 per cent. of the assessees' total income.[2] A second cause of inequality was to be found in another feature of the bill which attracted considerable attention in India and in Great Britain. This was the provision relating to the exemption of Government servants from the proposed taxation. This clause was omitted during the second reading of the bill, but not before the policy of the Government had been the subject of severe adverse and caustic comments in the contemporary newspapers. The London Correspondent of the *Friend of India* wrote on the 1st December, 1859 :

" They (certain of the leading newspapers) have reprobated in no measured terms against the exemption of the servants of the Government which it was sought to establish. That project has been defeated, but the odium of having proposed it sticks to the Government, and all the water in the river cannot wash out the stain. Public confidence can never again be placed in men who proposed to exempt themselves from taxation, to which they were ready to subject all other classes."

This condemnation of the Government servants was, however, unjust. For there were strong reasons which had

[1] Proceedings of the *Indian Legislative Council*, 27th August, 1859.
[2] *Ibid.*, 30th August, 1859.

led the Government to think that it was inexpedient that the provisions of the bill should extend to Government servants. These reasons were set forth in a letter from the Government of India, dated the 16th September, 1859, to the Secretary of State for India. In the course of this letter the Government pointed out that as the bill was intended to apply only to those exercising trades and professions, it was thought desirable to give it as little as possible the character of an income tax. At the same time the Government had no intention that, while fresh taxes were being imposed upon other sections of the community, their own servants should occupy a privileged position. In fact, as the Government pointed out, they had always intended that simultaneously with the passing of the bill for licensing of trades and professions a deduction was to be made equivalent to 3 per cent. of the official salaries.[1]

During the debates on the second reading it was felt that it would be much better to incorporate in the bill itself a provision regarding the taxation of Government servants. Accordingly Sir Barnes Peacock proposed that a provision be incorporated that all Government servants should contribute 3 per cent. of their salaries. It was not, however, considered expedient to extend the tax to salaried men, whether in Government or private employment, drawing Rs.100 or less per month.[2]

Even with the modifications thus introduced the tax failed to receive the approval of the public. The general complaint against the measure was that as the bill proposed to tax by means of licensing fees it was unequal in its operation, for persons with unequal incomes would have been subjected to equal taxes under it. The Calcutta Trades Association, in a letter dated the 1st September, 1859, made a formal protest against the inequality in taxation as contemplated in the bill. A petition of the inhabitants of Bombay, dated the 17th October, 1859, referred to the same objectionable feature. There were others who

[1] *Vide* Harington's speech, *Legislative Council*, 27th August, 1859.
[2] *Indian Legislative Council*, 30th August, 1859.

were opposed to it on the ground that profits from property and interest on Government securities were exempted from taxation. The inhabitants of Calcutta considered the bill as "an insult to the liberal and scientific professions" and a parallel to which it would be impossible to find in imperial or colonial legislation, for licences were usually taken out by hawkers and pedlars and not by members of the learned professions.[1]

The proposals incorporated in the bill met with strenuous opposition from the Governor of Madras, Sir Charles Trevelyan, and from many of his able and experienced officers. They pointed out the numerous objectionable features of the measure and opposed its enactment on financial, political and even on moral grounds. The bill sought to create a distinction as regards the taxable minimum between persons living by trade and business and those earning their livelihood from salaried employments. For the first class of people the taxable minimum was Rs.5½, while for salaried men it was fixed at Rs.100 a month. It was also pointed out by Mr. Pelly of the Board of Revenue that so far as the Madras Presidency was concerned, the licensing bill was not likely to bring an increased revenue, for this measure was designed to take the place of the *Mohturfa* and the *Veesabuddy*, which yielded a revenue of Rs.1,100,000 a year.[2]

The inquisitorial procedure sanctioned by the bill for ascertaining the profits of trades, the huge army of subordinate officers necessary to aid the Collector in the work of assessment, these and other defects were pointed out by Sir Charles Trevelyan in a lengthy minute on the subject which was based upon the views of his officers. Sir Charles observed:

> "This tax would again cover the country with a swarm of ill-paid, ill-superintended native subordinates with duties so favourable to underhand exaction that it would be impossible to prevent them from preying upon the people. . . . The experience I

[1] *Correspondence, Debates in the Legislative Council and Minutes relating to Direct Taxation in British India* (1882), Vol. I.

[2] *Vide* letter dated the 10th October, 1859, to the Chief Secretary, Government of Madras, *H. of C. papers*, 1860, Vol. XLIX, p. 279.

have had of the want of principle in making the returns to the income tax even in England makes me exceedingly dread the introduction of such an element of immorality and extortion in this heathen country." [1]

The political danger attendant on the introduction of such a tax reaching the poorer classes of inhabitants was referred to by Mr. William Robinson, the Commissioner of *Mofussil* Police in the Madras Presidency. He apprehended that the introduction of such a tax would give the people of India a common war cry and would tend to unite the diverse elements of the population. "Why, then," he observed, "give the *Mahajan* of the North-West Provinces, the *Pandit*, etc., of Benares, the *Shaukar* of Bombay, the *Brahmin* moneylender of Tanjore, and the Moplah trader of Malabar, a common war cry by sudden, simultaneous, general legislation of an unpopular character?" [2]

Nothing tangible resulted from Harington's bill. Mr. Wilson, who was sent out from England to rehabilitate India's finance, announced in the Legislative Council on the 18th February, 1860, that the Government of India had decided to withdraw the bill and introduce new measures. In withdrawing it Mr. Wilson observed:

"I am bound to say that we feel very sensible of the great advantages which have resulted from the discussions which have taken place upon that bill. We cannot doubt that they will tend very much to aid both the Government and the public in arriving at a wise and correct conclusion, and, sir, for this assistance I tender my cordial thanks to my honourable friend" (Mr. Harington).

The bill for licensing of trades and professions was abandoned, but it was clear that drastic measures were needed to relieve the financial situation which had grown from bad to worse. India's national debt, which stood at £81 millions in 1859, had swelled to £97·8 millions in 1860. The debt charge had also increased to £4·4 millions in the beginning of 1860. The year 1859–60 had ended in an

[1] Minute dated the 1st December, 1859—*H. of C. papers*, 1860, Vol. XLIX, pp. 299–305.

[2] Memorandum from W. Robinson, dated the 8th November, 1859—*H. of C. papers*, 1860, Vol. XLIX, pp. 295–6.

actual deficit of £9·2 millions, while the estimates for 1860–1 showed a prospective deficit of £6·5 millions.

Wilson's fresh Taxation Proposals.

In these circumstances Mr. Wilson proposed, among other measures, the imposition of an income tax and a licence tax. In commending his taxation proposals before the Legislative Council, Mr. Wilson pointed out that a less critical situation than that prevailing in India had called forth the need for the imposition of an income tax in England. When Sir Robert Peel introduced his income tax in England the total deficit during 1837–8 to 1841–2 amounted only to £7½ millions, while in India in the three financial years ending 30th April, 1860, there was an actual deficit of £30 millions.[1] Immediately after the introduction of the income tax bill in the Legislative Council, the Government of India addressed a private and confidential letter to the Governors of Bombay and Madras in which their views on the necessity of increased taxation were explained in some detail. The Government were emphatically of opinion that the insecurity of some of the sources of revenue, particularly from opium, combined with the urgent need for additional expenditure in the administrative departments, rendered fresh taxation imperative. Land revenue, which furnished two-thirds of the income of the Government at this time, was so high as to be oppressive in many cases; while, on the other hand, a most inadequate fund was available for public works so much required to develop the resources of the country. While the revenue position was so unsatisfactory, the prospect of a reduction of expenditure both civil and military was not very hopeful. The Mutiny had disclosed to the Government the danger they incurred in relying on the native army to a large extent. The Government felt that in future a large portion of the army must be composed of Europeans, and the employment of Europeans meant an addition to the military expenditure.

The income tax bill was passed into law as Act XXXII of 1860, and was intended to last for a period of five years.

[1] Wilson's speech, *Indian Legislative Council*, 18th February, 1860.

The other measure which Wilson proposed, viz., a licence tax, was also enacted in 1861.[1] As originally drafted the bill for licensing of arts, trades and dealings was intended to be universal in its operation, reaching all traders high or low without reference to their income. It laid down three rates of R.1, Rs.4 and Rs.10 to be paid by artisans, retail shopkeepers and wholesale traders respectively.[2] In June, 1860, the Select Committee appointed to consider and report on the measure introduced several changes, the most important on which was the inclusion of a provision requiring all dealers in tobacco to take out a special licence. The measure now took the title of "A Bill for imposing a Duty on Arts, Trades and Dealings and to require Dealers in Tobacco to take out a Licence." The modified bill was last before the Legislative Council in September, 1860, but no effective steps were taken to enact it before July, 1861. The Act as passed divided the assessees into three classes chargeable with annual duties of Rs.3, Rs.2 and R.1. The provision requiring dealers in tobacco to take out a licence was omitted. Persons paying income tax were exempted from the operation of the licence tax.[3] This last feature involved a radical departure from the original proposal of Mr. Wilson, who intended the licence tax to be universal in its operation.[4] The licence tax, therefore, became complementary to income tax. While the poorer classes were to be taxed by the licence tax, the upper classes were made to contribute by means of the income tax.

Wilson's Licence Act, XVIII of 1861.

The licence tax was estimated to produce a revenue of approximately £600,000. This tax was, however, not needed to restore financial equilibrium and was therefore repealed in 1862, even before it had been put into operation all over the country. To produce this revenue of £600,000 it would have been neces-

Repeal of Act XVIII of 1861.

[1] Act XVIII of 1861—*Licence Duty on Arts, Trades and Dealings.*

[2] Financial Statement, 1860–1; Proceedings of the *Indian Legislative Council*, 3rd July, 1st September, 1860, and 13th July, 1861.

[3] Section VII, Act XVIII of 1861.

[4] See *Moral and Material Progress Report*, 1861–2, Vol. I, p. 5.

sary to assess 4 to 5 millions of persons. The work of assessing such a large body of men would have imposed a heavy burden on the already overworked officials engaged in income tax work. By repealing this measure the Government were able not only to relieve a large class of poor persons from new payments, but to cut short those tedious processes of classification and assessment which involved much that was scarcely less harassing to the people than the taking of money from them.[1]

An impression had gained ground in the minds of some classes of the Indian population, particularly amongst the illiterate section composing it, that it was the Government policy to extract from the people as much as possible. The abandonment of the tax, after it had been partially put into force, removed dangerous impressions like these and also made the smooth working of the income tax possible to a large extent.

Under the scheme of income tax proposed by Wilson, the minimum taxable income was fixed at Rs.200 a year.

Wilson's Income Tax Act (XXXII of 1860).

The lowest rate of 2 per cent. was chargeable on incomes between Rs.200–499, while incomes of Rs.500 and above paid 4 per cent., of which 1 per cent. was appropriated to reproductive local works. The various classes of income chargeable with the tax were mentioned in four different schedules. Schedule 1 related to income from lands and houses. The second schedule brought under taxation incomes from trade and professions, while incomes from securities, annuities or dividends were chargeable under the third schedule. Salaried servants, whether under Government or private employment, were taxed under the last schedule.

The Act established a series of exemptions. Property dedicated to religious or charitable use, officers of Her Majesty's military or police force whose pay and allowances were less than those of a captain of infantry, naval and marine officers not above the rank of a lieutenant

[1] Statements made by Lord Canning and Mr. Samuel Laing in the *Indian Legislative Council* on the 26th February, 1862, on the occasion of the repeal of Act XVIII of 1861.

were exempted from the tax.[1] *Ryots* paying less than Rs.600, either as land revenue direct to the Government or as rent to a superior landlord, also enjoyed exemption from the income tax.[2] But incomes from land as such were not exempt.

Elaborate rules were laid down in the body of the Act specifying the manner in which profits accruing under various schedules were to be estimated. With regard to income from land, it was laid down that profits were to be estimated at one-third of the Government revenue in the case of lands held under temporary settlements and paying land revenue direct to the Government. Power was given to reduce such assessments on proof that the profits realized were less than one-third of the Government revenue. Landowners or tenants holding land under a settlement not subject to periodical revision were required to submit returns, showing the actual profits from their lands and were chargeable on such profits. A deduction from income tax was permitted in favour of landowners or occupiers of land if the rent was reduced in consequence of flood, drought or tempest.[3] With regard to income from Government securities, rules framed under the third schedule directed that Government promissory notes enfaced for payment of interest out of India should in all cases be " enfaced subject to the condition that the amount of any duties which might at any time be chargeable in India in respect of such interest should be deducted therefrom."

In estimating the profit from trade and manufactures taxable under the second schedule of the Act, practically the only deduction allowed was the cost of repairs of the plant and machinery based on an average of the actual cost incurred in the three years preceding the assessment. Rule 4, Section XCVIII provided as follows:

" In estimating the profits or income chargeable under Sch. 2, or for the purpose of assessing the duties thereon, no sum shall be allowed to be set against or deducted from such profits

[1] Sections CXXVII, CXXVIII, CXXXIII of Act XXXII of 1860.
[2] Section CXXX of Act XXXII of 1860.
[3] Rule 20, Section XCVII of Act XXXII of 1860.

or income on account of any sum expended for repairs of premises occupied for the purpose of such trade, manufacture or concern, nor for any sum expended for the repairs of any implements, utensils, or articles employed for the purpose of such trade, manufacture or concern, beyond the sum usually expended for such purposes, according to an average of three years preceding the year in which such assessment shall be made; nor on account of loss not connected with or arising out of such trade; nor on account of any capital withdrawn therefrom, nor for any sum employed or intended to be employed as capital in such trade, nor for any capital employed in improvement of premises occupied for the purpose of such trade, manufacture or concern, nor on account of any interest which might have been made on such sums if laid out at interest; nor for any debts except bad debts proved to be such to the satisfaction of the Collector or Commissioners."

Another rule provided that in estimating profits no deduction was to be allowed on account of any annual interest or annuity payable to any person out of such profits.[1]

The most significant omission from the list of permissible deductions is that relating to depreciation of plant and machinery. This omission may, however, be explained by a variety of circumstances. In the first place the use of costly power plants and machinery had not commenced so early as 1860 on a large scale. The need for depreciation allowance in respect of such plants was not, therefore, very keenly felt at the time. In the second place the English income tax law on which the Indian Act of 1860 had been avowedly based did not provide for any such deduction. Such deductions were allowed in England by law for the first time in 1878 under the Customs and Inland Revenue Act,[2] which provided for an allowance in respect of the diminished value by reason of wear and tear of plant and machinery. It was therefore too much to expect any such provision in the Indian law of 1860. In the third place the tax of 1860 was contemplated as a temporary measure rendered necessary by financial exigencies, and this fact perhaps explains the narrow conception of profits which the framers of the Act took.

[1] Rule 5, Section XCVIII of Act XXXII of 1860.
[2] 41 and 42 Victoria, Cap. 15, Sec. 12.

These taxation proposals met with considerable opposition both from official and non-official quarters. Prominent among the official critics stood Sir Charles Trevelyan, Governor of Madras, who vehemently denounced the policy underlying the imposition of fresh taxes, and suggested retrenchment of expenditure as a means of meeting the deficit which had arisen. It is well known that the publication of Trevelyan's views on the subject on his sole responsibility without consulting the members of his Executive Council led to his recall by the Secretary of State for India. In a minute dated the 20th March, 1860, Trevelyan characterized Mr. Wilson's proposals as "a leap in the dark."[1] He suggested the reduction of the native Indian army as a means of meeting the financial crisis, and protested against the use of force to impose upon the people of India a new system of taxation which was distasteful to them. The reductions in the customs duties which Wilson had proposed in his budget for 1860–1, he characterized as having been made in the interest of the ruling classes. Trevelyan observed:

Measure Opposed by Sir Charles Trevelyan.

> "The reductions from 20 to 10 per cent. on the principal articles of European consumption in this country, and the transfer to the free list of the principal raw materials of our home manufactures, have made the budget popular with the ruling classes, which represents what we call public opinion. In both points of view the arrangement is singularly advantageous to the European mercantile interest in this country."

Sir Charles was not inclined to take Mr. Wilson's figures relating to the prospective deficit of £6½ millions in 1860–1 very seriously. He deplored the "scantiness of the information" furnished in the budget statement, and earnestly pleaded for more caution in proceeding with the new tax measures in the following words: "If we are to have English budgets for India, let us also have English safeguards. Let us not have one measure of care for our own interests and another for those of our Indian fellow-subjects." The novel character of the tax proposed, he said, was an

[1] See *H. of C. papers*, 1860, XLIX, pp. 354–63.

argument against it, however perfect it might be from the point of view of equity. Trevelyan felt that India would much rather prefer the restoration of vexatious transit duties than submit to direct taxation which was calculated to rouse all the latent feelings of opposition. The authority of the Indian lawgiver Manu, which Wilson had quoted in support of his taxation proposal, was irrelevant; such quotations, he said, would have no more influence with the people of India than "quotations from rubric or canon law would have upon a country congregation in England suffering from the innovations of a reforming High Church clergyman." Trevelyan closed his minute with an earnest appeal on behalf of the Madras Presidency urging that his own Province, at any rate, should be exempted from the new taxes.

Reply to Trevelyan's Criticisms.

A minute of this kind containing charges of a serious character against the Government was hardly expected to pass without a challenge. The remark that the budget had been framed with a view to further European interests called forth an animated protest from Wilson. Speaking in the Legislative Council during the debates on the second reading of the income tax bill, he replied that for the first time in the history of India every member of the public service from the Governor-General downwards would be called upon to contribute by means of an income tax. "Was it," Mr. Wilson asked, "in the interest of Europeans that for the first time we proposed that they should pay a fair share of the necessary taxation of the country by having their profits made here or in England brought under taxation?" Mr. Wilson explained his position further in the minute of the 17th April, 1860,[1] in which he pointed out that the changes in the import customs tariff were needed because the consumption of the taxed articles was rapidly declining, while the reductions in the export tariff were made with a view to enable the producers of Indian raw materials to compete effectively in foreign markets.

It appears that at this time the Government of India

[1] *H. of C. papers*, 1860, Vol. XLIX, pp. 384–96.

contemplated the imposition of a succession duty as an alternative means of raising revenue, but the idea was abandoned because a duty on successions was likely to fall mostly on the natives of India to the exclusion of the Europeans, who generally went back to their own country on their retirement from India. The Queen's Proclamation had just then been issued guaranteeing equality of treatment to all, and Mr. Wilson and his colleagues felt that the good effect produced by that memorable declaration would have been seriously impaired by the imposition of a succession duty. The other serious charge which Sir Charles had made against the Government of India was that the avenues of retrenchment had not been explored at all. As Sir Charles put it: "Official hierarchies never look with favour on reduction of expenditure. . . . The favourite remedy at Calcutta, from the first, has been increase of taxation." It was not difficult for the Government of India to rebut this charge of extravagance. Military expenditure in 1856–7 stood at £11·4 millions. In 1857–8 this figure had risen to over £15½ millions, and to £21 millions in 1858–9. Retrenchments had brought it down to £16·8 millions in 1859–60. In 1860–1 Wilson put the military expenditure at £15·1 millions, and he anticipated that he would be in a position to reduce this estimate still further by £858,000. Reductions were also anticipated in the expenditure on the civil side.

The claim put forward by Sir Charles Trevelyan for the exemption of the Madras Presidency from the income tax was not taken seriously by the Government of India. The claim of the Madras Presidency for exemption could not be conceded without introducing complications of a serious nature in the actual working of the tax. It would have been difficult to impose a tax on official salaries in Bengal and Bombay, without subjecting the officials in Madras to the same tax.[1] An income tax to be successful must be universal in its operation. The Government of India

[1] See letter from the Government of India dated the 4th May, 1860, Home Department, Revenue No. 14 of 1860—*H. of C. papers*, Vol. XLIX, 1860, pp. 447–51.

realized this and rightly refused to agree to a proposal which would have made the tax local in its scope.

Publication of Trevelyan's Minute—His Recall.

The controversy between Trevelyan and Mr. Wilson attracted considerable public attention, the more so as the papers and despatches that passed between the two Governments were made public. The Government of Madras sent copies of Trevelyan's minute of the 20th March, 1860, to Mr. Forbes, who was then the official representative of the Madras Government in the Indian Legislative Council, and requested him to place these papers before the Legislative Council with a view to give them as much publicity as possible. The Government of India, when apprised of this intention, sent for Mr. Forbes at a meeting of the Executive Council held in Calcutta at Mr. Wilson's house, and prohibited him from obeying the instructions he had received from his own Government.[1] In the meantime, the Home Secretary to the Government of India despatched a telegram to the Chief Secretary to the Government of Madras, requesting that the papers should not be made public. The telegram was as follows:

> ". . . Having learnt that the Governor in Council has taken means to publish the same through the Legislative Council, I am to convey the strong opinion of the Government of India that it would be highly injurious to the Queen's Service that these documents should at present be made public in any way."

Sir Charles Trevelyan disregarded this injunction as to secrecy, and acting upon his sole responsibility distributed copies of minutes to the members of his Government, "with a view to secure for them the greatest possible publicity." In doing so, he was, as he himself explained in a minute dated the 4th April, 1860, guided by two main considerations. In the first place as the papers had already been sent to Mr. Forbes, the Madras representative in the Indian Legislative Council, he was likely to use them while supporting the views of his own Government. The publi-

[1] See letter, Public Dept., No. 42 of 1860, dated the 5th May, 1860, from C. E. Trevelyan, Pat. Grant, W. A. Morehead and E. Maltby to the Secretary of State for India.

cation of these papers would therefore have taken place in any case. In the second place Trevelyan wanted to influence public opinion in England. It was erroneously believed in England that the rising of 1857 was a popular upheaval against foreign rule. But as a matter of fact, as Sir Charles put it, " it was not the people but the army which troubled us; and the remedy is to reduce the army, and to put it upon a proper footing." [1] Sir Charles wanted to correct the view erroneously held in England, so that the pressure of English public opinion might compel Mr. Wilson to alter his budget proposals.

The action of the Government of India in silencing the representative of Madras was perhaps also one of the causes which had influenced the Governor of Madras in taking the action that he did. In the course of another minute to the Secretary of State written on the 1st May, 1860, Sir Charles attempted an elaborate justification of the procedure that he had adopted and expressed himself in the following terms:

"The Legislative Council of India is a free deliberative assembly. Its constitution and forms have been carefully arranged on that principle. It stands in the place of the local legislature which this Presidency formerly had; the difference being that instead of taking a direct part in legislation, as this Government formerly did, we act through a representative. The Executive Council has silenced that representative, and it has therefore become necessary for us to speak on our behalf. The answer ought to be made as public as Mr. Wilson's speech. The pretension that any one should monopolize free discussion, has never been heard of in the British Empire in the memory of the present generation." [2]

The Secretary of State strongly disapproved of the action of Sir Charles Trevelyan, as it was calculated to shake the authority of the Government of India. Trevelyan was accordingly removed from the office of the Governor of the Presidency of Fort St. George.[3] The recall of Sir Charles

[1] *H. of C. papers*, 1860, Vol. XLIX, p. 371.
[2] *Ibid.*, 1860, XLIX, p. 424.
[3] Despatch from the Secretary of State dated the 10th May, 1860, Public Dept.—*H. of C. papers*, 1860, XLIX, pp. 374-5.

put an end to the opposition from the Madras Presidency. But it must not be supposed that he stood alone in his condemnation of the tax. The Governor of Bombay, Lord Elphinstone, to a large extent shared Sir Charles' views, although he was not so outspoken as his Madras colleague. In a minute dated the 19th April, 1860, he expressed the apprehension that the tax was likely to prove unpopular, although the people might not risk any open opposition to the Government, as they were "too much cowed by the recent triumphant suppression of the most formidable insurrection of which history affords any example and by the presence in this country of an unusually large body of British troops." The news that the Governor of Bombay was hostile to the new tax leaked out, and one of the Indian newspapers in Calcutta published the general purport of Lord Elphinstone's minute, even before it had been received by the Government of India.[1]

Opposition to Wilson's Scheme from other Quarters.

There can be no doubt that the knowledge that the Governors of Bombay and Madras were opposed to the new tax stiffened public opposition. The difficulties of the Government of India, great as they already were, became very much intensified, for even the European inhabitants began to vacillate. The European residents in Madras had held a meeting before the publication of Trevelyan's minute, protesting against the imputation that they objected to be taxed. The same body of men held another meeting early in May, 1860, objecting to the new tax. The Indian Press also grew bolder and assumed an attitude of defiant opposition.[2] Mr. Wilson's proposal had thus to face a storm of hostile criticism even from quarters from which he had a right to expect some support. The burden of criticism was that it was a new and unfamiliar levy, repugnant to the feelings of the people. Even Lord Canning gave his assent to the proposal for the levy of an income

[1] *Vide* letter to the Secretary of State dated the 19th May, 1860, from Frere and Wilson—*H. of C. papers*, 1860, Vol. XLIX, pp. 471–3.

[2] Letter from the Government of India, Home Department, Revenue 19 of 1860, dated the 19th May, 1860—*H. of C. papers*, 1860, Vol. XLIX, pp. 471–3.

tax with utmost reluctance and solely on the ground of financial necessity. He is reported to have said: "Danger for danger, I would rather risk governing India with an army of only 40,000 Europeans than I would risk having to impose unpopular taxation."[1] But if the theory of origin of income tax presented above is correct, it would appear that this argument regarding the novelty of the tax was certainly much exaggerated. The tax was a new one in the sense that the machinery of assessment and the manner in which it was collected were unfamiliar to the people of the land. But an impost on trades and professions had more or less been a regular feature of the tax system of the country, long before the income tax was ever heard of. What Wilson proposed to do was to extend its scope a little, and to put it on a sound basis. It would be certainly safe to assert that there was no part of India where the income tax was as new to the people as it was in England when first imposed by Pitt in 1798.[2]

The System of Hypothecated Revenues Criticized.

Apart from the general condemnation of the measure in which nearly all sections of the community joined, a considerable volume of criticism was directed against the particular provision of the Act which provided for the imposition of an additional tax of 1 per cent. on all incomes of Rs.500 and above, and the utilization of the proceeds of the tax to reproductive public works. The original proposal was to utilize the receipts to "local purposes." Subsequently at the instance of Sir Barnes Peacock, the Legislative Council accepted the proposal that the words "reproductive public works" should be substituted for "local purposes." The criticism against this provision is best typified by the views of the then Governor of Bombay. "What interest," he asked, "has a retired annuitant or a pensioned officer living in Europe or still more an English holder of Indian funds who perhaps has never been in India, in the improvement of Calcutta or Delhi?" The answer to this

[1] *Vide* Q. 7474—Evidence of Mr. Laing—*Select Committee on East Indian Affairs*, 1871–3—28th June, 1872.

[2] See Note by Sir H. B. E. Frere dated the 24th April, 1860—*The Economist*, 18th August, 1860.

query obviously is that there are many works of public utility of a purely local character, which affect the State indirectly. It was necessary that such works should be constructed by the State if not undertaken by the local bodies from local funds. Roads, bridges and harbours were calculated to develop the resources of the country, and it was of the utmost importance that works of this character should not be neglected by the State. It may be noted here that the principle of raising loans for capital expenditure on productive works was first accepted in 1866.

While there was enough justification, having regard to the state of public works in India at the time for this appropriation, it is difficult to approve of another feature of the Income Tax Act which must appear archaic to modern students of public finance. This was the provision relating to the keeping of separate accounts of the proceeds of the 1 per cent. duty. Section CXCIII provided as follows :

" A separate account shall be kept of the duty paid in respect of the said 1 per cent. duty which shall accrue from the dividends or interests paid upon the Government debt and from the salaries of public officers and from the profits of any railway or other public company whose profits shall be derived from different parts of India. . . . The amount comprised in such account of the 1 per cent. duty shall be appropriated to the different Governments in India, to be applied according to their direction for the execution of roads, canals or other reproductive public works which have been duly sanctioned. Such appropriation to be made to each local Government in the proportion in which each Presidency or Lieutenant-Governorship or Province under a Chief Commissioner shall contribute to the whole amount of the duty raised under the Act."

This practice of earmarking separate heads of revenue for specific purposes disappeared in Great Britain with the establishment of the Consolidated Fund,[1] and its revival

[1] The system of hypothecating particular heads of revenue for specific purposes has been reintroduced in Great Britain in recent years, though on a small scale. In 1909 a Road Board was established and funds were placed at its disposal in the form of special taxation of motor vehicles. This fund is known as the Road Fund. In 1926–7 a sum of £21·6 millions

in India in a different guise was undoubtedly a retrograde step as having a tendency to complicate the accounts. The system also appears to be defective, as it gives either too much or too little for the object in view. Happily, the mistake of this policy was realized and the separate account of 1 per cent. was discontinued in 1862 as it was found difficult to carry out the provision of the Act.[1]

The Administration of Act XXXII of 1860.

The Income Tax Act of 1860 received the assent of the Governor-General on the 24th July, 1860, and forthwith went into operation. In some parts of the country, as, for example, in the Punjab and Oudh, an income tax was successfully launched on the authority of the Governor-General, pending sanction of the comprehensive financial measures in the Legislative Council. The basis of the tax in the Punjab was the scale of licence duties originally proposed in the Legislative Council. A tax of 3 per cent. per annum was imposed on all incomes below Rs.2,000 a year. Some of the more important cities in the Punjab were allowed the option to compound for the income tax by raising an equivalent revenue by means of octrois or town duties. The town of Amritsar proposed to raise its quota of the income tax by trebling the town duties.[2] This rough-and-ready income tax of 3 per cent. was not at all equitable, but as funds were urgently needed considerations of equity had to be sacrificed to those of convenience and expediency. The only argument in favour of this tax was that it had the effect of familiarizing the people with a direct tax assessed according to modern methods and was in the nature of a "feeler." With the passing of the Income Tax Act, octrois and town duties disappeared and the income tax took their place in the Punjab. In Oudh during the months of March–May, 1860, an income tax was successfully levied at

was credited to it. The sum thus credited is earmarked for adapting British roads to the demands of the new motor traffic. The "raids" that have been made on this fund from time to time show that the system of hypothecation is unsatisfactory.

[1] See section XV of Act XVI of 1862 and also evidence of Mr. T. L. Seccombe, *Select Committee on East Indian Affairs*, 1871, Q. 2763.

[2] *Moral and Material Progress Report*, 1859–60, Part IV, Chap. XII, Section II.

the rate of 3 per cent. Here the principle of lump assessment was tried under executive orders. The aggregate assessment was first fixed with the aid of either *Panchayets* or heads of trades, and the apportionment was made by the people themselves.[1] In large and populous cities the principle of individual assessment took effect. The result of the tentative levy was so satisfactory that Mr. Wilson was in a position to reassure the Secretary of State as regards the probable reception of the regular income tax. In May, 1860, he wrote to the Secretary of State that the tax was paid in Oudh "without a murmur." No trouble was apprehended in the North-Western Provinces with the example of Oudh on the one side and the Punjab on the other, while in Bombay the earnest co-operation of the Government was assured.

The situation, however, was not equally reassuring all over the country. In Peshawar, for instance, a riot took place which was speedily suppressed. The demonstration against the new tax was based upon the apprehension that the tax was about to be "levied upon priests, women, children, and even corpses." [2] In spite of the fact that the forerunner of income tax was well received over a large tract of the country, the Government of India were not without their misgivings regarding the way in which a fully-fledged income tax would be received. Hence it is that long before the Act was passed the Government of India published a vernacular pamphlet named the *Exposition of the New Taxes.*[3] The attempt to distribute these pamphlets brought the Government of India into yet another conflict with the authorities at Madras. The latter refused to distribute the pamphlets on the ground that such communications as were embodied in these papers were addressed by members of Parliament to their constituents in England. They were therefore utterly out of place in India. As a

[1] See letter to the Secretary of State for India, dated the 4th May, 1860, Home Department, No. 14 of 1860, written by H. B. E. Frere and James Wilson—*H. of C. papers*, 1860, XLIX, pp. 447–51.

[2] See letter from Lord Canning to the Secretary of State, 19th April, 1860.

[3] See *The Economist*, June 2, 1860—Letter signed by "R. T."; also minute by Trevelyan, 23rd April, 1860—*H. of C. papers*, 1860, Vol. XLIX, p. 455.

result of this protest, the distribution of these pamphlets was postponed till after the Act was passed. Besides distributing these pamphlets, orders were issued by the Central Government to all local Governments to the effect that an impression should not be allowed to prevail that the criterion of successful management was the amount of revenue raised. Every Collector of revenue was confidentially told that it was idle to expect perfectly true returns of property and income, and so long as the returns were not wilfully fraudulent they were to be accepted.[1]

The work of income tax administration was entrusted to the Collector of land revenue and his assistants, the Deputy-Collectors, who were appointed assessors under the Income Tax Act. The Collector was empowered to authorize the Deputy-Collector, if necessary, to assess all income and profits not exceeding Rs.1,000 subject to appeal to the Collectors. The assessment of income above this limit was left to the Collector. A special machinery was set up in the Presidency towns. To deal with income-tax work in these areas Commissioners were appointed, not less than six in number, of whom at least two were non-officials. The object of the introduction of the non-official element was evidently to obtain such an administration of the tax as might secure the confidence of the general public. The assessors in the Presidency towns acted under the general direction and control of the Commissioners. Power was also given to associate the representatives of the people with the work of assessment in areas other than Presidency towns. Sections CI–CVIII of the Act vested the local Governments with discretionary powers to direct that the work of assessment in selected areas should be made by *Panchayets* of not less than three persons appointed by the Collector. This agency was used in some of the more important towns which had agreed to the principle of lump assessments. The lump contribution of these cities was first fixed by the Government, and the sum thus fixed

[1] Letter from the Government of India, 10th August, 1860, to the Secretaries to the Governments of Bengal, Madras and Bombay, and the N.W. Provinces—*Correspondence, Debates in the Legislative Council and Minutes relating to Direct Taxation in British India* (1882), Vol. I.

was distributed *pro rata* amongst the contributors by the *Panchayets.* The institution of *Panchayets* was designed to protect the poorer sections of the community, but it was reported that the *Panchayets* lacked courage to charge the rich on the full value of their income.[1] In Allahabad, for instance, during 1861–2 the assessment fixed by the *Panches* had to be revised, and in only 267 cases was the assessment retained at the old level; in 682 cases the tax was increased, while in 2,184 cases it was diminished and 1,449 "parties" were entirely exempted.[2] Curiously enough, the use of this agency had sometimes, though in very few cases, the opposite effect of imposing a disproportionately heavy burden on the rich. In the city of Benares, for instance, where a lump contribution had been fixed in 1860–1, the more opulent residents had to take upon themselves the shares of those who had failed to pay. It was accordingly decided by the Government that the system of lump assessment should be discontinued from 1861–2, unless the people of Benares expressly wanted to adhere to it.

The Collector or the Commissioners issued general notices calling upon all persons liable to income tax to fill in returns of their income in a prescribed form.[3] In addition to this general notice, special notices were served by the assessor calling upon every person, who was in his opinion liable to the tax, to fill in a return of income within the prescribed time. The Act gave power to the Collector or the Commissioners to reject all returns if they were unsatisfactory, and to charge the assessee any sum by way of income tax.

Surcharge.

This power was known as the right to "surcharge."[4] It appears that though the Government of India had issued strict injunctions to the local authorities to the effect that the power to "surcharge" should be used as sparingly as possible, the circumstances were such as to necessitate the use of this reserve power in

[1] *Vide Moral and Material Progress Report*—the section dealing with the N.W.P., 1860–1.

[2] *Vide Income Tax Administration Report,* N.W.P., 1861–2.

[3] Section XXXVII of Act XXXII of 1860.

[4] Section LIV of Act XXXII of 1860.

a large majority of cases. Complaints were made from every part of the country that the surcharge in assessment was the rule in almost all cases. A report from the Secretary to the Government of the North-Western Provinces pointed out that taking the North-Western Provinces as a whole, the average percentage of surcharge to assessment was 65·2. If the districts were considered separately, in some of them the proportion of surcharge to assessment was as high as 80 or 90 per cent. or even higher. In the annual assessments under Schedules I, II and IV the returns of only 14,651 persons were accepted as correct in the North-Western Provinces in the year 1860–1. These assessees had returned an income of Rs.11,159,891 bearing a tax of Rs.396,334. The number of persons who were surcharged under the same schedules was 160,344. They had assessed themselves at an income of Rs.27,972,773 bearing a duty of Rs.810,670. The assessors, however, considered that their true income was Rs.78,809,405 bearing a tax of Rs.2,552,302.[1] In a note written in 1861, Mr. Samuel Laing,[2] the Finance Member, pointed out that surcharge or arbitrary assessment was universally necessary to attain anything like decent financial results. The income tax had been unpopular from the very beginning and the system of surcharge rendered it still more odious to the people. Mr. Laing thus described the feelings of the people of India with regard to income tax:[3]

> "Their picture of income tax is that of some great man from a distance or still worse, some native officer anxious to curry favour with great men, coming down on some unhappy district like a roaring lion, surcharging right and left without mercy, rating some poor widow or struggling tradesman at Rs.200 a year on the information of some enemy and hurrying off the next day without condescending to listen to any argument or appeal."

[1] *Report on the Operation of the Income Tax in the N.W.P.*, 1860–1.

[2] Samuel Laing (1812–97): He was called to the Bar in 1837. Shortly afterwards he was appointed Private Secretary to Henry Labouchere, then President of the Board of Trade. He distinguished himself as an authority on railways, and in 1844 published his *Report on British and Foreign Railways*. He entered Parliament in 1852. He was appointed Finance Member in 1860 in succession to James Wilson.

[3] *Report on the Income Tax Acts and a Minute on the subject of the amendment of these Acts by the Hon. Samuel Laing* (1861).

Reports from Bombay, Bengal and Madras disclosed that the returns were as a general rule inaccurate. Mr. Minchin, referring to the returns given by the Indian traders in one district of the Madras Presidency of which he was in charge, said that he had examined in his time cartloads of returns and soon came to the conclusion that they were mere waste paper.[1]

It would, however, be erroneous to suppose that the system of surcharge was entirely due to the fraudulent character of the returns submitted. In many cases surcharge was necessitated by the fact that the people were not familiar with the rules guiding income tax administration. Many persons, for instance, laboured under the belief that only such portions of income as remained after the household expenses had been met were to be returned. The difficulties of the Government were increased by the fact that accounts of traders were seldom properly and intelligently kept, a trader explaining the same page in an account book in different ways on different occasions without intending to defraud the Government.[2]

Amendments to Act XXXII of 1860.

During the five years that the Income Tax Act of 1860 lasted, such amendments and modifications were made from time to time as were necessitated by financial and administrative considerations. In 1862 the taxable minimum was raised to Rs.500 a year.[3] This amendment relieved a considerable body of tax-payers with only a negligible loss of revenue. It was estimated that persons with incomes between Rs.200–500 numbered about 600,000 and constituted two-thirds of the whole body of tax-payers. This large body of tax-payers paid a gross tax of £350,000 out of a total yield of £1,750,000. Mr. Samuel Laing rightly observed that a tax like this stood condemned by a mere statement of figures.[4] This reform exempted the poor and ignorant section of the tax-payers who were not so able to defend their rights and privileges as their more fortunate brethren. In 1863 the

[1] Proceedings of the *Legislative Council*, 31st March, 1868.

[2] *Report of the Commissioners of Income Tax*, Bombay, 7th May, 1861; also *Moral and Material Progress Report*, 1860–1, Chap. XII.

[3] Act XVI of 1862.

[4] *Financial Statement*, 1862–3.

rate of tax was reduced to 3 per cent. These changes are summarized in the table below showing the taxable income and the appropriate rates during 1860–5.

Year.	Taxable Income.	Rates.
	Rs.	Per cent.
1860–1	200–400	2
	500 up	3 and 1
1861–2	same as in 1860–1	same as in 1860–1
1862–3	500 up	3 and 1
1863–4	500 up	2 and 1
1864–5	500 up	2 and 1

Another amendment was designed to remove a particular feature of the Act of 1860, which had given rise to considerable dissatisfaction among the tax-paying public. There is no doubt that the annual returns contemplated by the Act of 1860 were largely responsible for the unpopularity of the income tax. To relieve the people from being harassed with fresh notices and forms of return power was taken under Act XXI of 1861 to dispense with these, and to accept as valid for the year 1861–2 the assessment of income already made in 1860. By Act XVI of 1862 fresh notices and returns were dispensed with for the years 1862–5. These measures, while they afforded relief to the tax-payers, enabled the Government to turn their attention to the assessment of incomes which had hitherto escaped taxation.

Repeal of the Income Tax, 1860.

The first income tax came to an end in July, 1865. Repeated promises had been made by successive Finance Members, Wilson, Laing and Trevelyan, that the income tax was not to be regarded as a permanent feature of the Indian fiscal system, and that it was rendered necessary only by financial necessity. In 1860 Mr. Wilson had observed that the tax was enacted only "for a limited period." His successor, Mr. Laing, had reiterated that promise. In 1864 Trevelyan had definitely announced that the tax would expire on the 31st July, 1865. The circumstances also seemed favourable

for the abolition of the tax, as a substantial surplus was anticipated in the estimates for 1865–6. But the Governor-General (Sir John Lawrence) was of opinion that in spite of the anticipated surplus it was necessary to continue the tax, as the future financial situation was uncertain. He referred to the fact that money was needed not only for the construction of barracks but also for the army and subordinate civil establishments due to the rise of prices, while the revenue position was unsatisfactory due to the uncertainty of the opium revenue. The Governor-General observed "it is very easy to give up a tax, but it is still more difficult to revive it." [1] He was, however, overruled by his colleagues in the Executive Council who took up the position that it was not possible to continue the income tax beyond 1865, without being charged with breach of faith. As Sir Charles Trevelyan put it, "great, mixed and half-civilized populations are influenced more by facts than by explanations." [2]

In this connection a contrast suggests itself between the history of income tax in India and that in Great Britain. Mr. Gladstone anticipated in 1853 that the British income tax would expire gracefully on the 5th April, 1860. His hope was, however, disturbed by the Crimean War, and in 1855 and 1856 income tax reached 1*s.* 4*d.* in the pound, the highest point reached since its reintroduction in 1842 until the outbreak of the great European War. Happily, no unforeseen event disturbed the financial equilibrium in India, and it was a source of genuine satisfaction to the Government of India that they were in a position to do without the tax in 1865. During the five years that the income tax was in operation, it yielded a sum of over 7½ crores of rupees, thus giving an annual average of over 1½ crores. The total annual yield from the various Provinces (with the exception of the amount realized from the Government servants) is set out in Appendix A. The total number of persons assessed and the amount of tax realized from the general public and

The Yield of the Tax.

[1] Minute dated the 30th March, 1865.
[2] Minute dated the 3rd April, 1865.

Government servants during 1860–1 to 1864–5 is shown below.[1]

Year.	General Public.		Government Servants.		Total.	
	No.	Amount.	No.	Amount.	No.	Amount.
		Rs.		Rs.		Rs.
1860–1 .	842,514	15,238,725	39,495	2,483,537	882,009	17,722,262
1861–2 .	1,017,038	15,741,071	38,313	2,933,141	1,055,351	18,674,212
1862–3 .	308,400	12,707,728	36,230	3,053,063	344,630	15,760,791
1863–4 .	217,006	9,506,745	20,593	2,424,783	237,599	11,931,528
1864–5 .	222,894	9,822,880	43,288	3,236,149	266,182	13,059,029

From the financial point of view the income tax was described as a failure by Mr. Samuel Laing in 1861.[2] The financially unproductive character of the income tax was due to various causes. The tax was introduced in an atmosphere of distrust and suspicion. Coming as it did after the Mutiny, there was a tendency to regard the tax as a fine for rebellion.[3] Even the Europeans were lukewarm in their support of the tax, if not positively hostile towards it. The tax therefore could be administered only by a series of guesses by the use of the "fiscal thumbscrew"—the right to surcharge. The extensive use of this device made the tax unpopular, and destroyed that general good will between the Government and the governed which was so essential to the successful administration of a tax of this kind. The work of assessment and collection was, as we have seen, entrusted to officers whose main duty was the collection of land revenue. The use of this agency no doubt kept down the cost of administration—the cost of collection during the five years was estimated at $3\frac{4}{5}$ per cent. of the gross collections—but at the same time it materially affected the yield. The officers were inclined to regard income tax work as of secondary importance and bestowed upon it as little time as they possibly could. Besides, as the tax was avowedly in the nature of a stop-gap, the officials were not perhaps very enthusiastic over it. Another

[1] *Report of the Select Committee on E.I. Affairs*, Vol. II, 1872, Appendix 20.
[2] *Financial Statement*, 1861–2.
[3] See the article on "An Income Tax for India"—*The Economist*, 7th November, 1885.

important cause which prejudicially affected the yield was to be found in the fact that assessments made in the first year of the operation of the tax were stereotyped till 1865 by the operations of Act XXI of 1861 and Act XVI of 1862. These two Acts allowed a diminution of assessment in every case where an individual's earnings had decreased, but there was no corresponding provision for an increase of assessment. The result was that assessments became quite obsolete, and ceased to bear any relation to the actual income of the assessees. Persons in receipt of salaries, of income from investments had to pay their full share of taxes, while professional men, bankers, traders and merchants escaped lightly. The assessments made during the first year which were inadequate and unequal, became more so with the increase of wealth that took place in the subsequent years, and the chief merit of a direct tax of this kind that it should be apportioned to the means of the tax-payer disappeared.

It would, however, be quite erroneous to judge India's first income tax from the financial standpoint. The framer of the measure was confronted with a difficult financial situation after the Mutiny. In his eagerness for increased revenue he failed to realize that an Income Tax Act based on the English model with its separate schedules, but unlike the English tax [1] in so far as it rested for its efficient working on returns of income submitted by tax-payers, was at this time utterly unsuited to a people with whom the idea of disclosing individual income was something novel and revolutionary. The unproductive character of the tax was due largely to the machinery set up and the method of assessment adopted. Yet one great merit might be claimed for the measure, and it was that the Act of 1860 laid down and for the first time acted upon an equitable principle that the capital and labour of India as well as her land should contribute in fair proportion towards the support of the State; the adoption of this prin-

The Educative Effect.

[1] *First Instalment of the Minutes of Evidence before the Royal Commission on the Income Tax* (Comd. 288–1, 1919)—Appendix 7 (*g*), Historical Note on Taxation at the Source.

ciple in the tax system of India as early as 1860 was itself an achievement well worthy of the highest praise. People realized for the first time that the State was justly entitled to call upon the more affluent citizens to contribute in proportion to their means. The work of "educating the assessees" of which we hear so much at the present time may be said to have commenced with the passing of this Act, and surely some credit is due to that distinguished financier upon whom fell the unenviable task of handling a difficult financial situation.

CHAPTER IV

THE LICENCE TAX OF 1867, AND THE CERTIFICATE TAX OF 1868

THE Income Tax Act was allowed to lapse in 1865. But the abrupt change in the financial situation soon after showed that the income tax, although it had not fulfilled the expectations formed about it by its framers, was yet needed to maintain financial equilibrium.

The year 1864–5 closed with a deficit of £193,520 [1] instead of the anticipated surplus of £823,288. The cause of this deficit is to be sought in the Bhutan War and in the rise of prices necessitating increased expenditure on the army and civil establishments. The next financial year was tided over with the aid of palliatives, but when in 1866–7 a deficit of £72,800 was anticipated it became clear to the most optimistically inclined member of the Government that the imposition of fresh taxes could not be delayed any longer. For the time being the deficit was met by a slight increase in the price of Madras salt. But the capricious character of the receipts from opium compelled the Government to look to more secure sources of revenue.

r's of Decentralization.

In February, 1866, the Finance Member, Mr. Massey,[2] addressed a semi-official letter to all the Provincial Governments inviting an expression of their opinions as to the best means of making provision for a permanent addition to the revenue of £1 million. He was contemplating at this time

[1] *Vide Financial Statement*, 1865–6.

[2] William Nathaniel Massey (1809–81) succeeded Sir Charles Trevelyan as Finance Member. He was called to the Bar in 1844, and in 1852 became member of Parliament for Newport. He was the author of *Common Sense versus Common Law*, and also of an unfinished *History of the Reign of George III*. He continued to act as Finance Member till 1868.

a scheme for the decentralization of Provincial finance as the best means of relieving the Central Government of some of their burdens. The idea was to raise a sum of a little over £1 million in rateable proportion in the several Provinces, and to apply this sum in relief of a corresponding amount of charge for Provincial services hitherto borne by the India Government.[1] The Provincial Governments were asked to consider the suitability of a (i) licence tax, (ii) house tax, (iii) octroi, and (iv) succession duty for raising the necessary sum.

The replies which were received from the Governments were not very encouraging. The Government of Bengal were opposed to any Provincial taxation, and suggested instead a transfer to the local Governments of a portion of the central revenue to be managed exclusively for the benefit of the Province in which the revenue was raised. Referring to the proposal to impose a licence tax, the Lieutenant-Governor of Bengal observed : " I very much doubt whether a licence tax on trades would yield anything like the amount which it was proposed to raise, and except in large towns its collection would be expensive and vexatious." [2] The Governor of Bombay suggested the reimposition of the income tax rather than the adoption of palliatives, while the Government of the North-Western Provinces, thus confronted with a definite proposal for the imposition of Provincial taxes, now suddenly discovered hitherto unlooked-for virtues in budget deficits. The latter pointed out that a deficit was not without its uses, and solemnly advised the Government of India to practise economy rather than to impose fresh taxes. In the opinion of the Government of the North-Western Provinces, a licence tax was likely to be more injurious to Her Majesty's Government than fiscally advantageous. The Government of Madras remarked that of the four taxes suggested by the Finance Member, the licence tax and the house tax were already in operation, and had been handed over to the municipalities. They were opposed to the octroi, as such duties placed power in the hands of men who were likely to abuse it. They rejected

[1] Semi-official letter dated the 21st February, 1866.
[2] Letter of C. Beadon, 8th March, 1866.

the idea of a succession duty as they thought it would not be financially productive.[1]

The financial year 1866–7 drew to a close. The revised estimate for the year disclosed an actual deficit of £2,395,247. In the next year, in presenting the Financial Statement, Mr. Massey had to again contend with a deficit even after taking credit for the new customs and stamp duties which were proposed. In face of these recurring deficits the Finance Member thought it expedient to postpone for the time being the scheme of decentralization, and tackle the problem of budget deficits in a more direct fashion.

The problem of equitably distributing the burden of fresh taxes inevitable under the circumstances did not present any difficulty to the Finance Member. The fundamental principle in his code of financial ethics was that under no circumstance should the income tax be revived, as in his opinion it should be regarded as an extraordinary source of revenue to be used only on occasions of emergency. So strongly did he feel against the revival of an income tax that he said: "Nothing on earth should induce me to hold office in India as the Financial Member, if the condition imposed upon me by the Secretary of State was the maintenance of an income tax as an ordinary source of revenue." [2] A general income tax being out of the question, the problem arose as to which particular section could justly be called upon to bear the burden of fresh taxes. As a considerable proportion of public revenue in the shape of customs and excise was derived from the labouring classes, the Finance Member felt that no extra taxes could be imposed upon them. It would have been equally unjust, according to him, to call upon the landholder and the fundholder to pay any additional "direct tax which did not include other sections of the community." By a process of elimination Mr. Massey concluded that the trading and professional classes and salaried servants should make good a part of the anticipated deficit. He

Licence Tax.

[1] It must be remembered in this connection that what the scheme proposed was not the imposition of graduated death duties, but the levy of a small fee.

[2] *Vide* Q. 8582—*Select Committee on E.I. Affairs*, 1871–3, 9th July, 1872.

therefore suggested the imposition of a licence tax on these classes. Thus it happened that while only two years ago all classes of the community were contributing in proportion to their ability, by a curious process of reasoning men in receipt of " earned income " were penalized, while the fundholder, for instance, was left in the secure possession of his revenue.

While thus suggesting a licence tax, the Finance Member did not altogether abandon the idea of the introduction of his scheme of decentralization. He was not without hopes that he would be in a position to transfer this licence tax to the Provinces, along with corresponding charges of a local character. He observed :

" In our opinion a tax of this nature is better suited to local purposes than to the general purposes of the State. We intend, therefore, in another year to transfer it, modified if experience shall suggest such modification, together with a corresponding amount of charges of a local character, to the several local Governments and administrations." [1]

It was not, however, given to Mr. Massey to carry out this idea, and the licence tax, which lasted only for a year, took effect as a central source of revenue.

Under the terms of the Licence Act [2] annual licences had to be taken out by persons and companies exercising trades and professions and enjoying a minimum annual income of Rs.200 a year. The maximum assessment or the assessment on the lowest estimated income of each class was fixed at 2 per cent. The scale of taxes fixed for individuals was different from that fixed for companies. The highest amount payable by any individual was Rs.500, while that payable by a company was Rs.2,000.

The following was the scale fixed for individuals :

			Rs.
CLASS I	Persons whose annual profits were estimated	at Rs.25,000 and upwards .	500
,, II	Do.	at Rs.10,000 but less than 25,000	200
,, III	Do.	at Rs.5,000 but less than 10,000	100
,, IV	Do.	at Rs.1,000 but less than 5,000 .	20
,, V	Do.	at Rs.500 but less than 1,000 .	10
,, VI	Do.	at Rs.200 but less than 500 .	4

[1] *Vide Financial Statement* for 1867–8.

[2] Act XXI of 1867—An *Act for the Licensing of Professions and Trades.*

As originally drafted there were only five classes in the bill, and the highest fee payable by any individual was Rs.200 only. At the instance of Mr. Cowie, a non-official member of the Legislative Council, a sixth class was added, thereby raising the maximum fee payable to Rs.500. The Act drew a distinction as regards tax-paying liability between salaried servants of the Government and those in private employment. For the former the taxable minimum was Rs.1,000 a year, while as regards the latter it was fixed at Rs.200.[1] Following the precedent set by the Income Tax Act of 1860, the Licence Tax Act exempted from its operation certain military officers, e.g., officers of Her Majesty's Forces or Her Majesty's Indian forces whose pay and pensions did not exceed Rs.6,000 per annum and who were not in civil employment other than employment in the police, non-commissioned officers and privates similarly employed, and officers of any police force whose pay and allowances were less than those of a captain of infantry in Her Majesty's forces in India.

The scale of taxes fixed for companies was as follows :

	Rs.
" For every company whose stock or funds is or are divided into shares and transferable, with a paid-up capital exceeding 10 lakhs of rupees or £100,000 . . .	2,000
For every such company with a paid-up capital exceeding 5 lakhs or £50,000 and not exceeding Rs.10 lakhs or £100,000	1,000
For every other such company duly registered, which in the half-year next preceding the date of its licence shall have paid a dividend at or above the rate of 5 per cent. per annum, and whose profits for the year preceding such date shall have exceeded Rs.10,000	500 "

While under the Income Tax Act of 1860 a person liable to tax was required to fill in a return of income, it was dispensed with under the new Act. Such was the general scheme of licence tax adopted by Mr. Massey. It was a very crude substitute for an income tax. It is true that in avoiding an income tax he got rid of the evils of inquisitorial methods, but at the same time, in trying to make

[1] Section III (4), Act XXI of 1867.

the licence tax productive, it was necessary to spread it over a wide area, with the result that the evils of taxation were multiplied. The table in Appendix B shows the collections in the different Provinces (exclusive of the contributions by the Government servants), as also the receipts from the several classes of tax-payers. It will appear from this table that the total number of persons brought under the Licence Act exclusive of Government servants was 730,422. If to this figure we add the number of Government servants who paid the tax, the total comes to 742,889. This number contrasts very unfavourably with 266,182, which represented the number paying income tax in 1864–5. With all this extension of tax to persons in receipt of Rs.200 a year, the Finance Member could show a revenue of a little over Rs.6,200,000 as against more than Rs.13,000,000 in 1864–5.

Mr. Massey did not agree with those who argued that the tax descended too low in the scale of incomes. On the contrary he felt that it would have been unjust to exempt from taxation the class earning from Rs.200–500 a year, because he believed that, so far as the traders were concerned, they would escape the tax by shifting it on to the consumers. But it did not occur to him that the process of shifting was at best a halting one and was likely to be retarded by economic friction. Then again, even assuming that the whole of the tax was shifted to the consumers, there remained a residue of burden in the shape of diminished sales which was not transferable. The fact is that the position which the Finance Member took up was illogical and untenable. He wanted to exclude from taxation the labouring classes who, as he put it, contributed to the customs and excise, and yet he argued that the tax would not be felt by the traders because they would shift it on to the consumers.

For the pains that Mr. Massey took in avoiding inquisitorial inquiries, he had not even the consolation arising from the knowledge that the measure was popular in the country. The trading and professional classes could not approve of a measure which brought under taxation the precarious profits of personal labour, while it left untaxed

the secure income derived by the fundholder. The Bengal Chamber of Commerce condemned the tax as "an inequitable weight thrown upon national industry," [1] and the Chamber had sufficient justification for thus condemning it. Under the terms of the Licence Act a company with a capital of a little over Rs.1,000,000 had to pay the same tax as one with a capital of Rs.10,000,000. Not only were companies with varying amounts of capital taxed equally, but the tax had no relation whatsoever to their earning capacities. It levied on a company earning a dividend of 5 per cent. per annum the same amount of tax as on one earning 50 per cent. Again, many of the companies taxed under the Licence Act were registered abroad and maintained only agencies in India. In the case of such companies their capital abroad was no criterion of their profits earned within India. Take, for instance, a company registered abroad with a total capital of a little more than Rs.1,000,000 and maintaining an agency for the purchase of goods in India. Under the provisions of the Licence Act such a company was bound to pay a tax of Rs.2,000 a year. When we consider that the whole capital might not have been used in India, it appears unfair to place such a company on a footing of equality with another whose whole capital was so utilized. A tax like this, so crude and so palpably unfair, stood self-condemned. A memorial was addressed by the Calcutta Trades Association to the Secretary of State for India requesting him to veto this measure. The Secretary of State, however, declined to interfere on a review of the financial position in India.[2] But the Government of India soon found it necessary to bring forward an amending bill with a view to redress the grievance of non-Indian companies, maintaining only agencies in India. The amending Act laid down that such companies were to be taxed not according to their capital, but at the rate of 2 per cent. on their profits earned in India.[3]

[1] See letter of the *Bengal Chamber of Commerce* dated the 23rd March, 1867, in the *Report for the half-year ending 30th April*, 1867.

[2] Despatch No. 221, 14th June, 1867, from the Secretary of State.

[3] *Vide* Act XXIX of 1867—*An Act to explain and amend Act XXI of* 1867—Section 4.

The scheme of licence tax introduced in 1867 was characterized by inequality from start to finish. In the first place it was unequal in the sense that it singled out for taxation only a particular section of the community, viz., the trading and professional classes. In the second place even as regards the section brought under taxation there was inequality, because of the division of the tax-payers into a small number of classes. The result was that an individual with an income of Rs.25,000 a year had to pay the same tax as one with Rs.50,000 a year. Again, there was no justification for the distinction that the Licence Act drew between the taxable capacities of Government servants on the one hand and salaried men in private employment on the other. Lastly, it introduced an element of territorial inequality, certain areas being given a more favourable treatment than the rest. Many of the Provincial towns had imposed licence taxes of their own with a view to raise money for local purposes, before such a tax came to be used by the Government of India as a central source of revenue. The question therefore arose whether the central and local licence taxes should be imposed simultaneously. With a view to avoid overlapping, power was given under the Licence Act to the Collector to make an abatement to the extent covered by the local tax.[1] The result was that localities in which funds were raised by octroi or house tax, or by any means other than a licence tax, obtained no exemption at all. But municipalities in which local licence tax existed as an instrument of revenue, obtained exemption to the extent of such tax.

The licence tax lasted for one year only, and when the budget proposal for 1868–9 came to be considered the whole issue regarding the desirability or otherwise of the retention of the licence tax was reopened. The Finance Member proposed the continuation of the tax in a modified form. The most important modifications proposed were the raising

[1] *Vide* letter of G. of I. dated the 16th March, 1867, written in reply to the protest of the British Indian Association dated the 8th March, 1867; also instructions dated the 13th March, 1867, to all local Governments from E. H. Lushington, Secretary to G. of I., Finance Department. See also section IV, Act XXI of 1867.

of taxable minimum from Rs.200 to Rs.500, and the reduction in the rate of the tax to 1·6 per cent. The proposal to continue the tax in a modified form gave rise to a controversy between the Governor-General and the Finance Member on the one side and the Commander-in-Chief on the other. The point at issue was whether public works like roads, military barracks or irrigation works should be constructed out of current revenues or loans.[1]

Proposals for 1868-9—Certificate Tax.

It is now generally recognized as prudent finance to borrow for the purpose of enabling the State to embark on commercial enterprises which are expected to pay a return sufficient for interest and depreciation charges. Such remunerative public works throw no burden upon the community.[2] Besides, if the credit of the State is used for such enterprises, violent changes in taxation are avoided.[3] Provided that the Government pursue a sound policy in fixing rates and charges for services which are provided out of such undertakings, there is no reasonable objection to the use of the credit of the State for such works. But no clear-cut and definite line of action can be laid down with regard to projects that are not expected to yield any financial return, but which are of general social advantage. The policy should vary according to the particular circumstances of the case. If reliance is placed on loans to an undue extent for such works, the State may find its credit resources used up when confronted with a grave national emergency. But from this it does not follow that such works should always be financed out of current revenues. We may conceive of a case in which the outlay on works of public improvements of this character is so heavy that the policy of constructing them out of taxes may impose a heavy burden upon industry and initiative. Under such circumstances credit should enter as a necessary adjunct to taxes, provided the loans are paid off by taxes before the need for similar expenditure is expected to arise. Then again, as

[1] Minute by Sir W. R. Mansfield, 14th March, 1868; also by Sir John Lawrence, 18th March, 1868.

[2] Dalton: *Public Finance*, 1923, Chap. XXII, p. 196.

[3] Pigou: *A Study in Public Finance*, p. 232.

Professor Pigou has pointed out, in a society in which money income is rising steadily and continuously, a loan policy may be justified in as much as the rate of taxation required for the service of a given money debt will fall automatically.[1] But it is dangerous policy to allow Governments always to rely on this possibility in future. It is therefore prudent for Governments not to rely on loans for non-remunerative public works unless absolutely necessary.

As we shall see later on the Government of India based their loan programme on these considerations a few years later. Remunerative public works were constructed out of loans, while the cost of works of a non-remunerative character was defrayed out of current revenues.[2] But as yet this policy had not definitely crystallized, with the result that there was noticeable a good deal of vacillation regarding the course that should be adopted.

The budget for 1867–8 was based on an estimated revenue of £46,783,000 and expenditure amounting to £47,340,000. The expenditure thus exceeded the estimated revenue by £557,000. In the middle of the financial year, however, with the permission of the Secretary of State for India a sum of £1 million was borrowed, and a part of the expenditure on public works was defrayed out of this sum. The result was that instead of the anticipated deficit there was a surplus.[3] When the budget for 1868–9 came to be framed, the policy followed in 1867–8 of defraying the charges of public works out of loans was abandoned, such charges being debited to current revenues. The Commander-in-Chief, Sir W. R. Mansfield, took up the standpoint that the Government of India were maintaining taxation at an unduly high level for the construction of works which were to benefit posterity. He refrained, however, from offering

[1] *Vide* Pigou: *A Study in Public Finance*, p. 233.

[2] Compare in this connection Sir Richard Temple's observations: "The principle of the distinction is clear. All public works, however beneficial indirectly, are to be provided for from the ordinary revenue of the year, and those works only are to be treated as extraordinary and provided for by loan which will yield a direct cash return to the treasury."—*Financial Statement*, 1869–70.

[3] When the budget figures for 1867–8 were revised subsequently on the basis of the distinction between "ordinary" and "extraordinary" public works, it was found that the year had actually ended in a deficit.

opposition before the public in India, particularly as the Finance Member and the Viceroy were agreed about the need for extra revenue.[1] The Secretary of State for India, to whom the views of the Commander-in-Chief and those of the other members of the Council were forwarded, overruled these objections and the modified licence tax went into operation.[2]

Assuming for our purpose that it was both just and expedient to raise extra revenue by taxation, the question arises whether it was equitable to maintain a partial and one-sided tax of this nature. Why, it may be asked, should the trading and professional classes alone be singled out to pay for the construction of barracks, irrigation works and other works of public utility? The Finance Member attempted an elaborate justification of the policy of the exemption of the landholders and the fundholders from taxation. He said: [3]

> "It is merely a war of words to say that the land tax is a rent. The fact remains that the landholders whose title is indefeasible so long as they pay the tax, contribute £20 millions a year to our revenue. It may be that the tax is not sufficient; that those who pay it at least under the Bengal Settlement made a very good bargain, but it is a bargain by which we are bound."

Little did the Finance Member imagine that the Bengal landholders for whom he was pleading so eloquently in 1868 would be brought under a general scheme of income tax in the very next year. Mr. Massey sought to justify the exemption of the fundholders by the curious reasoning that while the traders benefited by everything which promoted the prosperity of the country, the fundholder derived no such benefit. When confronted with the patent fact that the fundholders were taxed under Wilson's income tax of 1860, he could only reply apologetically that on the occasion of the Mutiny "the existence of England as a nation was in peril." [4]

The new tax which was imposed in 1868 in place of the

[1] Minute by Sir W. R. Mansfield, 14th March, 1868.
[2] *Vide* letter of 9th July, 1869.
[3] *Vide Financial Statement* for 1868–9.
[4] *Legislative Council Debates*, 31st March, 1868.

licence tax was known as the certificate tax.[1] It was merely a continuation of the licence tax with a few modifications. The taxable minimum was reduced to 1·6 per cent. The yield of the tax from the various classes of tax-payers, exclusive of the Government servants, is shown in the table given in the Appendix C. Government servants who came under the operation of the tax numbered 37,511 and contributed Rs.724,380. It will be seen from the table that the number of tax-payers was reduced from 742,889 under the licence tax to 263,765 under the certificate tax, while the revenue fell from a little over Rs.6,200,000 to Rs.4,518,918.

Main Features of the Certificate Tax, 1868.

One criticism which was levelled against the licence tax was its inequality. It was now sought to mitigate this partially by increasing the number of classes liable to take out a licence. The licence tax had stopped at an income of Rs.25,000, income above this level having been chargeable with the same tax, as an income of Rs.25,000. This provision was now modified and the classification taken up to Rs.400,000. The preferential treatment accorded to inhabitants of certain localities was now done away with, and all persons brought under the operation of the central tax. Suitable modifications were also made regarding the manner in which companies and partnerships were taxed. Under the licence tax partners of a firm were individually taxed. This was not an equitable method of assessing partnerships, for the principal partner might be living out of India and escape taxation altogether, while the business of the partnership might be looked after by another person having only a small pecuniary interest in it. The Certificate Tax Act provided that the tax should be assessed on the firm as such and not on the individual members constituting it.[2] The companies were now given the option of being taxed at the rate of 1 per cent. on their declared profits, or at the rate of Rs.500 in respect of every place in India in which they carried on their business.[3]

[1] Act IX of 1868—*An Act for Taxing Professions and Trades.*
[2] Section III (4), Act IX of 1868. [3] Section XXII, Act IX of 1868.

The Certificate Tax Act, while it introduced a more rational method of taxing companies, gave rise to complications of its own. The terms of the Act were not very clear regarding the liability to taxation of companies which earned no profits at all. Were such companies to be altogether exempted or were they to pay at the rate of Rs.500 in respect of the agencies maintained? A letter addressed by the Bengal Chamber of Commerce on this subject to the Government of India elicited the reply that the Chamber was right in supposing that in the event of no dividend being declared, the company could claim exemption from the tax.[1] Another question which arose was with regard to the manner in which companies registered in England were to be assessed. Were such companies to be assessed on their entire profits whether earned in India and elsewhere or only on their Indian profits? The Bengal Chamber of Commerce apprehended that if the intention of the Government was to assess only on the Indian profits, "it would be impossible to determine this amount with accuracy." On the contrary, if the Government intended to tax such a company on its entire profits it would lead to glaring injustice. Again, if the company exercised the option and chose to be taxed at the rate of Rs.500 in respect of each of its agencies the result would have been equally oppressive. The decision of the Government was that the tax was to be charged on the entire dividend of the company irrespective of the place where it was earned.[2] The bearing of this on the problem of double taxation within the British Empire will be considered in a subsequent chapter.[3]

The modifications thus introduced marked an improvement on the old licence tax, but they failed to give satisfaction to the commercial community. The official supporters of the tax, however, thought that the unpopularity of the measure was the strongest possible argument for retaining it. They maintained that the tax touched only a

[1] *Vide* letter from the Bengal Chamber of Commerce to the Government of India, 18th April, 1868, and the reply thereto.

[2] *Vide Half-yearly Report of the Bengal Chamber of Commerce, ending 30th April,* 1868.

[3] Chapter XV.

small fraction of the people of the land, and caused far less annoyance to the natives of India than Wilson's income tax " with all the cumbrous machinery imported into it." [1] John (afterwards Sir John) Strachey remarked :

> " If the tax is open to reproach, it is not, I think, that it goes too far, but that it does not go far enough. . . . I cannot deny that this tax is unpopular with the most influential part of the community upon whom it falls . . . then I say that so far from this unpopularity being a reason for not imposing such taxation in times of peace, it is the strongest possible reason for doing so. . . ." [2]

Indeed, it was openly asserted by the official spokesmen in the Legislative Council that it was only the European residents who were opposed to the tax, while the natives of India preferred the inequalities of the licence tax to the theoretical fairness of an income tax coupled with harassing inquiry into private affairs. Mr. Minchin, one of the official spokesmen in the Indian Legislative Council, made a pointed reference to the European community in the following words : " There is one section of the community numerically weak as compared to the natives, but powerful in their energy and their influence with whom this tax is essentially unpopular, who use the acknowledged inequalities of the licence-tax system as a vantage ground for attacking it." [3] All this may be true. But the impression which the story of the vicissitudes of direct taxation leaves on one's mind is that the problem which is now regarded as one of paramount importance, namely, the equitable distribution of the burden of taxation in a community, never disturbed the equanimity of the Government. They were satisfied so long as they obtained their revenue, no matter how it was obtained.

[1] Minchin's speech in the *Legislative Council*, 31st March, 1868.
[2] *Indian Legislative Council*, 20th March, 1868.
[3] *Indian Legislative Council*, 31st March, 1868.

CHAPTER V

INCOME TAX, 1869–73

THE inequality in the distribution of the burden of taxation, which was one of the prominent characteristics of the tax system of India as it stood in 1868, was largely modified in 1869, when the exigencies of finance necessitated the conversion of the certificate tax into an income tax. The licence tax and its successor the certificate tax failed to bring equilibrium to the Government of India's budgets. The main disturbing factor was the public works expenditure.

By this time the Government had evolved a definite, consistent policy regarding the manner in which public works were to be financed. On consultation with the Secretary of State for India it was decided to divide public works into two classes. All works which did not yield a direct money return, but were indirectly beneficial, were treated as "ordinary" and constructed out of current revenues. Under this category came barracks and communications, while those works which yielded or were expected to yield a direct cash return were regarded as "extraordinary" [1] and were constructed out of loans. This new distinction necessitated a revision of the budget figures of the previous years, and the state of affairs which they disclosed was anything but satisfactory.

It was found that the year 1867–8 had ended in an actual deficit of over £1 million, while the revised figures for 1868–9 showed again a deficit of the same magnitude. The deficit of these two years joined to that of 1866–7 brought the

[1] It may be noted in this connection that it is not quite appropriate to use the term "extraordinary" to describe works the expenditure on which has a tendency to recur from year to year.

total to nearly £5 million. Thus three consecutive years ending in 1868–9 left a legacy of indebtedness, although no unusual or extraordinary circumstance had happened to affect adversely the finances of the Government. Fresh taxation being urgently needed, it was decided to convert the certificate tax into an income tax. The Government of India accordingly put forward the proposal before the Secretary of State in two despatches dated the 18th September, 1868, and 10th November, 1868.[1] The last despatch is important, as in it the opinion is expressed for the first time most definitely and clearly that an income tax should form a permanent feature of the fiscal system, and that such a tax should continue to be imposed irrespective of the budget calculations of the year.

The Re-imposition of Income Tax—Controversy in Viceroy's Executive Council.

"We are convinced," said the Government of India, "of the general necessity of an income tax forming for the present a part of our fiscal system, looking to the growth of expenditure in every direction, to the natural demand for improvement of all kinds, to the need of increased funds for public works, to the fact that loans have been found indispensable for reproductive works. We are of opinion that a moderate income tax is essentially necessary for the present in reference to the general condition of Indian finance as it has been in the immediate past and as it must be in the immediate future."

The views put forward in these despatches as to the desirability of having a permanent income tax in India were not shared by the Commander-in-Chief, Sir W. R. Mansfield, and the Law Member, Sir Henry Maine. The Commander-in-Chief ventured to differ from those who seriously believed everything the petty subordinate officials said regarding the popularity of the certificate tax in the country, as these officials were not likely to give any information

[1] Sir Richard Temple (1826–1902) was the Finance Member at this time. He succeeded W. N. Massey in April, 1868, and was in charge of India's finance till January, 1874. He came out to India in January, 1847, and for a period of about ten years served in various subordinate capacities. He acted as Chief Commissioner of the Central Provinces (1862–7), Lieutenant-Governor of Bengal (1874–7), and Governor of Bombay (1877–80). His publications include the following: (i) *India in 1880*, (ii) *Men and Events of My Time*, and (iii) *The Story of My Life*.

which might be disagreeable to the ruling powers of the day. The Law Member also thought that the people tamely submitted to the certificate tax not because of its popularity, but because of relief from the income tax which they hated more than the certificate tax.[1] The Governor-General (Sir John Lawrence) held a much more reasonable view. He felt that in view of the financial situation, the scope of the certificate tax should be extended and the fundholder and the landowner placed on the same footing with respect to taxation as other classes of the community. He was not one of those who regarded the income tax as an emergency measure to be imposed only in times of national peril. Such a time was particularly unsuited to the introduction of this tax by a foreign ruling power.[2] The members of the Provincial Governments who were consulted were practically unanimous in recommending an income tax. They pointed out that the unpopularity of the tax of 1860 was due to the manner in which it was first assessed and the machinery by which it was worked.

The Income Tax Act of 1869 (Act IX of 1869: an Act for imposing duties on income and profits arising from offices, property, professions and trades) fixed the taxable minimum at Rs.500 a year. It will be noticed that this figure was identical with that fixed in the previous year under the Certificate Tax Act. The general rate of duty was 1 per cent. The tax was assessed without any returns from individuals, it being understood that persons liable to duty would aid the Collector by disclosing such facts as might enable him to make a correct assessment. No difficulty was likely to be experienced in the assessment of salaries, pensions and other fixed incomes, which can always be determined with accuracy. But professional earnings are variable, and as the Act did not empower the Collector to call for returns from individual assessees, rough assessment was all that could be attempted. The Collector was required to make a

Provisions of Act IX of 1869.

[1] See Minutes by Maine and Mansfield, dated the 16th September, 1868, and 24th October, 1868.

[2] Minute by the Governor-General, 3rd November, 1868.

rough guess of the income within certain limits. Incomes under Rs.1,000 were to be estimated within a margin of Rs.250. From Rs.1,000 to Rs.2,000, the margin fixed by the Act was Rs.500. For incomes above Rs.2,000 it was fixed according to the following scale:

Income.	Margin. Rs.
Between Rs.2,000 and under Rs.10,000	1,000
,, Rs.10,000 and under Rs.100,000 . . .	2,500
,, Rs.100,000 and upward	10,000

With regard to these earnings which could not be determined with accuracy, the tax was imposed at 1 per cent. per annum on the minimum income, together with an addition of two-fifths of the difference between the maximum and the minimum to cover any broken sum. It is on this principle that the scale given below was fixed:[1]

"Persons whose annual income or profits shall be assessed at: Not less than

Rs.500,	but at	less than	Rs.750,	shall	pay	Rs.6.0.0
750	,,	,,	1,000	,,	,,	8.8.0
1,000	,,	,,	1,500	,,	,,	12.0.0
1,500	,,	,,	2,000	,,	,,	17.0.0
2,000	,,	,,	3,000	,,	,,	24.0.0
3,000	,,	,,	4,000	,,	,,	34.0.0

And for every additional Rs.1,000 of annual income or profits or fractional part thereof, so long as the whole amount assessed is less than Rs.10,000, shall pay an additional duty of Rs.10.0.0.

	Rs.
Persons whose annual income or profits shall be assessed at not less than Rs.10,000, but at less than Rs.12,500, shall pay	110.0.0
Persons whose annual income or profits shall be assessed at not less than Rs.12,500, but at less than Rs.15,000, shall pay	135.0.0
And for every additional Rs.2,500 of annual profits or fractional part thereof, so long as the whole amount assessed is less than Rs.1 lakh, shall pay an additional duty of	25.0.0
Persons whose annual income or profits shall be assessed at not less than Rs.1 lakh, but at less than Rs.110,000, shall pay	1,040.0.0

[1] *Vide* Schedule A, Act IX of 1869.

	Rs.
Persons whose annual income or profits shall be assessed at not less than Rs.110,000, but at less than Rs.120,000	1,140.0.0
And for every additional Rs.10,000 of annual income or profits or fractional part thereof shall pay an additional duty of	100.0.0"

The companies were taxed at the rate of 1 per cent., but with this modification on the old certificate tax, that only the profits made in British India and not their entire profits were chargeable.[1] This was a decided improvement upon the certificate tax under which the companies smarted under a sense of injustice.

Income from securities was also brought under taxation. The argument which was advanced only a year ago to justify the exemption of this income from taxation was now abandoned without the least hesitation, and a more reasonable view taken that the fundholder was as much interested as the recipients of other income in the maintenance of the credit of the Government.[2] Curiously enough, this argument was held not to apply to the non-resident fundholder. This was an unjustifiable departure from the wholesome practice initiated by Mr. Wilson in his Income Tax Act of 1860, for under this last measure, enfaced rupee paper, the interest on which was payable abroad, was subject to taxation equally with securities the interest on which was payable in India. The effect of the exemption of the non-resident fundholder was that nearly one-quarter of the rupee debt escaped taxation altogether; for it was estimated at the time that out of the rupee debt of £64 millions about £27 millions were held by Europeans in India, £15 millions by Europeans in Great Britain, and only £10¾ millions by the natives of India.[3] This exemption, however, lasted for only two years and was withdrawn in 1871.

[1] Section X, Act IX of 1869.

[2] Temple's speech, *Financial Statement*, 1869–70. Sir Richard Temple said: "The fundholder in India, conscious that the value of his property in the market so largely depends on the financial credit of the Government, will not demur to a contribution to a tax which in England has been always held to be applicable to income from public securities."

[3] *Financial Statement*, 1868–9.

Agricultural income was also taxed precisely as in 1860. The Government realized that while the precarious profits of trade and the hard-earned salaries and income of the professions were being taxed, it was unfair to exempt the income of a permanent character such as that enjoyed, for instance, by the Bengal *Zemindars* whom Strachey characterized as the richest class in all India.[1] Power was given to the executive to make the necessary deductions for expenses of management.

Modifications in the Tax of 1869.

The budget framed in March, 1869, was based on the assumption that with the income tax levied at 1 per cent. the year would close with a surplus of £50,000. During the course of the year the financial situation altered, and it was estimated in September, 1869, that, far from there being a surplus, the year would actually close with a deficit of £1,700,000. The main causes of the estimated deficit were the fall in the price of Malwa opium exported from India and the diminished yield of income tax. The receipts from the income tax were less than the estimated amount by about £220,000.[2] In order to meet this deficit, the Government were forced to reduce the expenditure of the Public Works Department and impose fresh taxes. Besides increasing the salt tax in the Bombay and Madras Presidencies, the rate of income tax was raised from 1 to 1½ per cent. in the middle of the financial year by Act XXIII of 1869 (an Act to enhance the duties leviable under the Indian Income Tax Act) which came into force on the 1st December, 1869.[3] Under section 2 of this Act, 2½ per cent. was levied on salaries, pensions or annuities, instead of 1 per cent. fixed under Act IX of

[1] Strachey's speech in the *Legislative Council*, 11th March, 1869.

[2] Sir Richard Temple's speech, *Legislative Council*, 19th November, 1870; also Lord Mayo's speech, *Legislative Council*, 31st March, 1871.

[3] Sir Richard Temple points out (*The Story of My Life*, Vol. I, p. 205) the circumstances under which this enhancement of taxation took place. On his return from England, Temple was informed by Lord Mayo about the disturbance in the budgetary equilibrium. The Finance Member was asked whether he was prepared for the odium of proposing an increase of taxation in the middle of the year. He answered that as the Government had already made up their mind, the increase should take place. As to the odium he could bear it, so long as he commanded the confidence of the Viceroy.

1869. It was necessary to impose a tax of 2½ per cent. during the period December–March in order to bring the rate up to 1½ per cent. in respect of the entire year's income. Similarly with regard to companies it was provided that an additional ½ per cent. should be paid on the whole profits of the year.

The Yield.

The total yield of the tax during 1869–70 was Rs.11,728,787, and the number of persons brought under taxation was 580,062. The table in Appendix D shows the collections from the different Provinces exclusive of the contributions from the Government servants. When it is recalled that during the last two years of the operation of the income tax of 1860 the rate of the tax was 3 per cent., it will be readily admitted that the yield of the new tax compared very favourably with that of the old. The Act of 1860 was a complicated one, following very much the provisions of the English income-tax law. Those elaborate rules were done away with in the Act of 1869, and in their place was substituted a simple measure whose basic principle was the desire to avoid oppression by petty officials. Inquisitorial inquiry was avoided as far as practicable, the inequalities associated with the licence and the certificate taxes for the most part disappeared and, barring a few minor evils associated with the administration of the tax, the Government had reasons to congratulate themselves on their achievement.

Income Tax during 1870–1.

The enhancement of the income tax in the middle of the financial year was followed by still further increase in the beginning of 1870–1. It was announced by the Finance Member in presenting the Financial Statement for 1870–1 that, in spite of large reductions of expenditure amounting to £1½ millions, there was anticipated a deficit of £1⅓ millions. The main disturbing cause was the anticipated fall from opium revenue due mainly to the expansion of opium cultivation in China. It was accordingly decided to raise the income tax to 6 pies in the rupee or to 3⅛ per cent.[1] The Finance Member hoped that this high rate of tax would only be temporary, but he could

[1] Act XVI of 1870—*An Act for imposing Duties on Income and Profits.*

not hold out any definite promise. The repeal or modification of the tax, he said, must be entirely dependent on circumstances.

The taxable minimum remained the same as under the Act of 1869. But one great change was introduced regarding the manner of assessment. The form in which income tax was reintroduced in 1869 did not contemplate the submission of returns by the assessees. With the increase in the rate of assessment in 1870 from 1½ per cent. to 3⅛ per cent. it was not found possible to maintain the principle of rough assessment, particularly with regard to income higher up the scale. Accordingly, the Collector was required to call for returns in the case of incomes of Rs.2,000 a year or more, while with regard to incomes below Rs.2,000 a discretionary power was given to him. He could, if he so desired, call on persons in receipt of such incomes to fill in returns of their income and profits. The principle of rough assessment was therefore kept up with regard to incomes below Rs.2,000 a year. The amount of tax payable on such incomes is shown below: [1]

Income.	Tax. Rs.
Persons whose incomes were estimated at Rs.500 but at less than Rs.750	19½
Do. do. at Rs.750 do. Rs.1,000	27
Do. do. at ,, 1,000 do. ,, 1,500	39
Do. do. at ,, 1,500 do. ,, 2,000	54

Incomes of Rs.2,000 and above were chargeable at 6 pies in the rupee. This new tax came into operation from the beginning of the financial year 1870–1. During the course of the next few months it became known that the year 1869–70, which was estimated to close with a large deficit, had ended much more favourably. The Bengal Chamber of Commerce accordingly wrote to the Government of India that in view of the prosperous condition of the finance, as disclosed in the latest available accounts for 1869–70, the rate of the income tax should be substantially reduced for

[1] Schedule I to Act XVI of 1870.

the half-year beginning with the 1st October, 1870.[1] In the course of this letter the Chamber observed that two additions to the income tax within less than a year had given rise to widespread feelings of irritation and distrust amongst the natives of India—" feelings hardly suggestive of actual political danger "—but still such as it was most desirable to modify and subdue. The Government of India were unable to agree with the Chamber in this pessimistic outlook, as the tax was paid by only a small fraction of the population. They pointed out that such a tax could hardly be said to affect the masses.[2] The Bengal Chamber of Commerce was not satisfied with this reply, and expressed its regret at the determination of the Government to carry on the ordinary administration of the country with the " perilous assistance of a war tax in time of peace."

The yield of the income tax at the enhanced rate was quite satisfactory. The amount actually realized was Rs.20,711,846, which compares favourably with the realizations in 1869–70. In the very next year, as an improvement in the financial situation permitted of the reduction of the tax, the Finance Member proposed to reduce the rate of the tax from 6 pies in the rupee to 2 pies, and to raise the taxable minimum from Rs.500 to Rs.750 a year. The main cause of the improvement in the financial situation was the increase in the receipt from opium. Besides this, the budget for 1871–2 provided for reductions in various items of army expenditure, e.g., the cost of provisioning European troops, the cost of feeding army remounts. The actual results of 1870–1 also showed a surplus of £1½ millions instead of the anticipated deficit of £1⅓ millions. In reducing the rate of income tax and in raising the exemption limit, the Government were actuated by a desire to retain the tax as a source of revenue so that it might be made available in times of financial difficulties in the future, and at the same time to avoid hardship to persons in receipt of small incomes.

Income Tax in 1871–2.

[1] *Vide proceedings of the Bengal Chamber of Commerce*, letter dated the 10th August, 1870.
[2] *Vide* letter dated the 3rd September, 1870.

Act XII of 1871: its Main Provisions.

The Income Tax Act of 1871 [1] resembled in its main features the Act of 1870. Under the Act of 1870, in case of incomes of Rs.2,000 or more the Collector was bound to call for returns. This limit was now raised to Rs.4,000 a year, and option was given to the Collector to call for returns in the case of incomes below this limit.[2] This provision dispensing with returns in the case of smaller incomes and the raising of the exemption limit to Rs.750 a year had the desired effect of relieving the poorer tax-payers. Another feature of the tax of 1871 which marked an improvement on that of 1869 and of 1870 was that relating to the taxation of securities. Under Part IV of the Act XII of 1871 a yearly duty of 2 pies in the rupee was leviable on all securities of the Government of India, irrespective of the residence of the holders of such securities. The result was that enfaced rupee paper, the interest on which was payable abroad, was now brought under taxation. In anticipation of the imposition of a tax on the non-resident fundholder the Government of India had issued the following notification in the Gazette of India: [3]

"NOTICE is hereby given that henceforth all Promissory Notes of the Government of India, which shall be enfaced for payment of interest thereon in London by drafts on India, will be enfaced subject to the condition that the amount of any duties which may at any time be chargeable in India in respect of such interest, shall be deducted therefrom at the place where the payment is made by a Draft on India or otherwise and a Draft given for the balance only."

It was estimated that during the year 1870–1 some £2 to £3 millions worth of enfaced paper had been sent abroad, and the effect of the Act of 1871, which made all Government securities chargeable with a rate of 2 pies in the rupee, was to bring under taxation the whole of this enfaced paper. The discrimination which the Act of 1869 had introduced between the resident and the non-resident fundholder disappeared with the passing of the Act of 1871. It will be noticed from the Government notification

[1] Act XII of 1871—*An Act for imposing Duties on Income.*
[2] Section 23, Act XII of 1871.
[3] *Vide* Notification dated the 28th May, 1870

quoted above that the device of collection at the source was introduced with regard to securities the interest on which was payable abroad. At the same time this procedure was extended to securities the interest on which was payable in India. The reason for the adoption of this step was that although, under the Acts of 1869 and 1870, assessees were bound to furnish a true and complete statement of their income from all sources, including the income from securities, yet in the vast majority of cases this was not done. Government were, therefore, forced to adopt this device in order to prevent fraud and evasion.

As originally drafted the income tax bill of 1871 contained no provision regarding its duration. But at the instance of Mr. Cowie, a member of the Legislative Council, Sir Richard Temple accepted the amendment that the Act "shall cease to be in force on the 31st day of March, 1872, except as to taxes then due. . . ." While accepting this amendment the Finance Member could not hold out any hope that the tax would not be continued after 1872. He was of opinion that the question of the abolition of the income tax should be considered in connection with the repeal of the salt duty, and a number of duties on the export of agricultural products.[1]

Income Tax Act of 1872–3, Act VIII of 1872.

The financial situation in the next year did not, however, permit of the total abolition of the tax, though it was found possible to raise the exemption limit once more. The budget for 1872–3 estimated a revenue of £48,771,000 and an expenditure (ordinary) of £48,534,000, thus leaving a small surplus of £237,000. It was therefore impossible to give up the income tax, as without it there would have resulted a deficit. Hardship to the poor was avoided by raising the taxable limit to Rs.1,000 a year, though the rate remained at 2 pies in the rupee. Fresh returns from assessees were dispensed with under section 22 of the new Act, which provided as follows: [2]

[1] *Report of the Select Committee on I.T. Bill*, 27th March, 1871—*Proceedings of the Indian Legislative Council.*

[2] Act VIII of 1872—*An Act for imposing Duties on Income.*

"Every person chargeable under this part shall, if he was assessed under Part V of Act XII of 1871 on an income of Rs.1,000 or upwards, be assessed at the same amount as that at which he was assessed under the said Act; but any such person may apply under the provisions of Part VI to have such assessment reduced or cancelled."

It was also laid down that in the case of incomes above Rs.4,000 which came under assessment for the first time during the year, the Collector was bound to call for returns. The combined effect of these two rules was that all assessments which were made in the preceding year were accepted as valid, fresh returns being called for in the case of new assessments above Rs.4,000. With regard to new assessments of income between Rs.1,000–4,000, a discretionary power was vested in the Collector, who could either call for such returns or dispense with them.

As was the case in the previous year, the Finance Member could not give any definite assurance regarding the repeal of the tax. "We are unable," said the Finance Member, "to afford any indication as to whether the income tax should or should not in the future be made an integral part of our fiscal system." [1] The proposal for the continuation of the income tax met with strenuous opposition in the Legislative Council, particularly in view of the fact that the financial position had improved considerably. Mr. Robinson voiced the feelings of those who felt that there was no longer any justification for the retention of the tax. Mr. Robinson said:

"I will vote against the bill because I think that in the very prosperous state of the finances of the country, the Government is pledged to withdraw the emergent tax—imposed as it was for the definite purpose of restoring equilibrium which was attained two years ago, and of removing a deficit which no longer exists—and because the proceeds of the tax have gone to swell undue cash balances."

The Finance Member earnestly pleaded for the continuation of the tax, inasmuch as due to remissions and amendments which raised the exemption limit from Rs.500

[1] *Financial Statement*, 1872–3.

to Rs.750 and from Rs.750 to Rs.1,000, "the wind has, as it were, been taken out of the sails of the unpopularity argument—till it at last is flapping idly." He claimed further that the imposition of the income tax in India had a most wholesome effect on public opinion, inasmuch as the tax encouraged economy in public finance. Public opinion, he said, had an innate tendency towards extravagance, but the moment the pockets of the rich, the clamorous and influential were touched by an income tax, the otherwise irrepressible tendency is repressed, and public opinion becomes bent upon economy, partly from the fear of direct taxation being increased, partly in the hope of such taxation being mitigated.[1]

Repeal of the Income Tax in 1873.

In spite of his remonstrances the Finance Member had to yield to this clamour in 1873–4. The budget for that year provided for a small surplus of £220,000, even without the aid of an income tax. It was therefore abolished. In a minute remarkable alike for its breadth of outlook and cogency of reasoning, the Finance Member argued that the abolition of the income tax was injurious to the stability of the finances, to the administration of the public services and to the welfare of the community.[2] He pointed out that the Secretary of State had repeatedly urged upon the Government of India the necessity of framing their budgets on the basis of a surplus of at least a million pounds;[3] the continuation of the income tax would have enabled the Government to provide for a surplus of more than £¾ million, and this opportunity for carrying out the wishes of the Secretary of State should not be missed. The tax, with its exemption limit fixed at Rs.1,000, did not affect the poor, who were powerless to protect their own interests. Apart from these considerations, he felt that the income tax was needed to redress the balance which in India

[1] *Legislative Council,* dated the 17th April, 1872.

[2] Minute dated the 2nd April, 1873—*H. of C. papers,* 1875, LIV, pp. 672–85.

[3] *Vide* despatches from the Secretary of State for India, to the Government of India dated the 14th June, 1867, 9th July, 1868, and 29th July,

inclined too much in favour of the rich and the influential class and too much against the poor. The Finance Member was supported in his expression of these views by the Commander-in-Chief, Lord Napier. The latter urged the continuation of the income tax, as it was the only direct tax which affected the European and Indian commercial communities, and begged his colleagues on the Government not to be carried away by the plaudits emanating from those who would be relieved from taxation. He said " while the applause resound near the seats of European Government and of mercantile resort, the sounds of distress from increase of the land assessment may be heard in the distant parts of the country." [1]

These views, however, did not appeal to the Viceroy, Lord Northbrook, who fell back upon the old and worn-out arguments regarding income tax being an emergency levy unsuited to times of peace.[2] The tax was given up precisely at a time when people were getting accustomed to the levy, when protests against it were getting fewer in number and the machinery for its administration was being slowly perfected. Considerations of equity were disregarded. It was overlooked that the only effective means of demanding a contribution from the richer classes was the income tax. With suitable modifications the tax might have been retained as a permanent source of revenue, adding an element of strength and equity to British Indian finance and the proceeds utilized in remitting taxation of a more onerous character. These considerations were disregarded and the clamours of the influential few prevailed over the interests of the unrepresented many.

Administration of the Tax—1869–73.

We have thus far followed the varying fortunes of the income tax during 1869–73. We have seen that the taxable minimum was fixed at Rs.500 during 1869–71 it was raised to Rs.750 during 1871–2 and finally increased to Rs.1,000 during 1872–3. The total number of persons assessed to income tax was

[1] *Correspondence, debates in the Legislative Council* and *Minutes relating to Direct Taxation in British India* (1882), Vol. I.

[2] Minute dated the 14th April, 1873.

580,062 during 1869–70, the raising of the exemption limit in 1871–2 reduced the number to something like 240,000, while in 1872–3 the number was still further reduced to 180,000. The rate of the tax was at first 1 per cent., and then $1\frac{1}{2}$ per cent. during 1869–70, $3\frac{1}{8}$ per cent. during 1870–1, and 2 pies in the rupee or a little over 1 per cent. during 1871–3. These changes were no doubt desirable in themselves and were mainly designed to relieve hardship to the poor. But at the same time it must be observed that constant changes in the rate of taxation as of taxable minimum, added to the unpopularity of the tax and increased the scope for bribery and corruption. The Lieutenant-Governor of Bengal, speaking in the Legislative Council, felt that the measure should be either adopted as a permanent engine of taxation or abandoned altogether, as considerable irritation and injury were bound to result unless the system was deliberately settled. These views were shared by the Secretary to the Board of Revenue in Bengal, who pointed out that no system of constantly changing taxes could succeed in India. Equally emphatic was the opinion of Sir W. Muir, the Lieutenant-Governor of the North-Western Provinces, who said in his letter to the Government of India :[1]

> " It would seem wiser and more stateman-like in dealing with a people so impatient of inquisition, so suspicious of change, and so difficult to reach by our explanation to make the tax precise and unvarying both in its reach and in the conditions of its assessment."

That bribery and corruption existed in an unusual degree in the income-tax administration during 1869–71 was the serious charge openly brought forward in the Legislative Council by Mr. Inglis, senior member of the Board of Revenue in the North-Western Provinces. He pointed out that in making assessments the usual practice was that the Collector deputed the *Tahshildar*, who in his turn deputed the *Quanango*. These were officers in receipt of a small pay of Rs.15–20 a month. The *Quanango*, not knowing anything about the local conditions in the village,

[1] *Vide* letter dated the 25th January, 1872.

usually took recourse to the *Patwari* or the *Lambardar*, who was perhaps equally ignorant. The *Patwari* and the *Lambardar* had the power to exclude and the power to assess; every one wanted to be out of the lists and to be safe for the future, and the village officers were often bribed for the envied privilege. Mr. Inglis remarked:

> "It is, I believe, no exaggeration to say that for every man who pays income tax to Government twenty pay to get off, and for every rupee that is paid into the treasury another is paid to the subordinate native officials, i.e., the natives of India paid last year upwards of 2 million pound sterling as income tax, and upwards of 2 millions more as bribes." [1]

Charges of such a sweeping character were too serious to be ignored. The Government of India forwarded these statements to the Government of the North-Western Provinces and called for an inquiry and report. The North-Western Provinces Government pointed out that the views of Mr. Inglis were undoubtedly much exaggerated, but taking his statements as figures of speech and as expressive of a very general prevalence of oppression and corruption, they were, speaking broadly, at one with him.[2]

It is not a matter of surprise to find the tax unpopular during the first two years, when it reached persons in receipt of a minimum income of Rs.500. In Bengal, during 1870–1, out of 127,078 assessments, objections were filed in as many as 90,784 cases. Of these objections, again, as many as 48,128 were successful.[3] One fruitful source of discontent was the manner in which the cultivators of the soil were assessed in Bengal. A fictitious profit was assigned to a *bigha* of land, the profit varying with the nature of the crops. Mr. Money, Secretary to the Bengal Board of Revenue, pointed out that it was among the class of cultivators that the assessments were most unequal. The cultivators were no doubt exempted with the rise in

[1] Speech in the *Legislative Council*, 17th March, 1871.

[2] See G. of I. letter No. 1940, dated the 30th March, 1871, also letter of N.W.P. Government, 3rd July, 1871—*H. of C. papers*, 1872, XLIV, p. 271.

[3] See the remarks of the Lieutenant-Governor of Bengal on the administration of the income tax in Bengal during 1870–1.

the limit of taxable minimum, but not before the tax had excited feelings of intense hostility against the Government.

Many of the district officers, upon whom fell the task of supervising the administration of the tax, were of opinion that the income tax had the effect of alienating the masses of the people from the rulers. The Lieutenant-Governor of Bengal quoted the opinion of one officer, who was formerly received everywhere as the representative of a friendly Government, but who, after the imposition of the tax, was mobbed in the interior of the district by people who made a grievance of "*takus, takus, takus.*"[1] The Sessions Judge of Jounpur (N.W.P.) quoted the opinion of a local Raja, who, in describing the feelings of the people against the income tax, represented that the people were at first dissatisfied, then *oodas* (desponding), and then, as the heavy percentage of 1869–70 was promulgated, became *mugra* (sullen). The Collector of Shahranpur (N.W.P.) observed that the same people who used to crowd round the Collector and take delight in talking to him, now avoided him as far as possible because he happened to be the tax-gatherer. These views of the district officers were borne out by the Lieutenant-Governor of the North-Western Provinces, who said that in course of his long service in India he had never witnessed anything approaching the popular discontent created by the income tax during 1869–71.[2]

Another defect in the administration which calls for notice was the inequality in the operation of the tax. The tax became in some parts of the country a charge only on landed proprietors, Government servants, and on income from securities. The profits of the trading classes often escaped taxation altogether, or did not pay their proportionate share. In Burma, for instance, the Chief Commissioner pointed out that the income tax had

[1] "*Takus*" is the Indian peasants' way of referring to a tax. See the *Report of the Select Committee on I.T. Bill*, 27th March, 1871.

[2] Letter from Secretary, Government of the N.W.P., 11th December, 1872, to the Secretary, Government of India. See also the opinion of Bankim Chunder Chatterjee, Deputy Magistrate, Berhampur, in his letter dated the 17th September, 1872—*Reports on Taxation in British India*, 1872, pp. 183, 171.

for all practical purposes degenerated into a tax on official salaries.[1]

Many of the defects of the income-tax administration which have been referred to above disappeared with the raising of the exemption limit. In Bengal, for instance, the ryots as a class were excluded, and there was a noticeable improvement in the public attitude towards the tax. The literate public realized that the tax, as it stood in its modified form during 1871–2 and 1872–3, touched only the affluent classes, and Indian-owned newspapers began to sing the praise of a tax which affected the wealthy classes and the European commercial community only. The Finance Member, when confronted with the charge that the tax was unpopular with the masses, effectively quoted the opinion of the *Amrita Bazar Patrika* and the *Shoma Prakash*. The *Patrika*, in its issue of the 25th January, 1872, pointed out that, inasmuch as the tax was paid by only one person out of 800—" certainly the one unfortunate may hate the tax and abuse the Government but 800 people will, with uplifted hands, pray for the prosperity of a Government which has saved people who are poor, and tax those only who can afford to pay." The *Shoma Prakash* joined issue with the London *Times* when the latter denounced the tax as unsuitable to the natives of India. In the opinion of the Indian paper, the poor natives had very little to do with the tax. It regarded the tax as a most equitable one, as it took from those alone who were able to give.[2] The tax, however, never became very popular with the European commercial community, who, although they became gradually reconciled to it as an evil which had to be endured, considered it as unjust.

Mr. J. Bullen Smith, President of the Bengal Chamber of Commerce, was of opinion [3] that the tax even in its

[1] *Vide* the letter of Hon. A. Eden, dated the 10th November, 1872, also the letter from Secretary to the Chief Commissioner, British Burma, dated the 16th November, 1872, to the Secretary to the Government of India—*Reports on Taxation in British India*, 1872, p. 8.

[2] Sir Richard Temple's speech in the *Indian Legislative Council*, 17th April, 1872.

[3] Speech at the half-yearly meeting of the Bengal Chamber of Commerce, 31st May, 1872.

mildest forms was so utterly unsuited to the country, and its attendant conditions so necessarily and irremediably bad that its retention among the sources of ordinary revenue should not be tolerated, and that it should be laid aside at the earliest possible opportunity to be reproduced in a time of dire extremity—such as the Mutiny deficit which had first called it into existence. When at last the tax was repealed in 1873 Mr. Bullen Smith congratulated the commercial public on the disappearance of what he described as "an obnoxious tax," and on the favourable circumstances which had permitted its extinction.

Bribery and corruption no doubt existed in the administration of the tax, but it must be admitted that they were due to causes which were removable. John (afterwards Sir John) Strachey, member of the Viceroy's Executive Council, referring to the charges of corruption brought by Mr. Inglis, said that so far as Northern India was concerned, if any Collector or Commissioner admitted that these abominations were going on as a common and universal practice, he had given the most complete evidence of his utter incapacity for performing his duties.[1] The Finance Member, arguing in the same strain, referred to the fact that abuses undoubtedly existed in land settlements and in the police. "Are we therefore," he exclaimed, "to give up settling the land revenue, to give up irrigating, to give up administering the law, to give up protecting property and so on?" The scope for corrupt practices was reduced with the raising of the exemption limit,[2] and there is no doubt that it would have diminished still further with the creation of a permanent staff charged with the special duty of administering the tax. Thus in Bengal during the first two years of the administration of income tax, a heterogeneous body of men was appointed as special assessors to assess the tax on persons with low incomes. The Collectors of districts were personally required to deal with incomes of Rs.10,000 or more. But the smaller

[1] John Strachey's speech in the *Indian Legislative Council*, 17th March, 1871.

[2] See the petition presented by the Rajshahye Association to Henry Fawcett, M.P.—*Reports on Taxation in British India*, 1872, p. 178.

incomes were assessed by men who had served as head clerks in the Collector's office or had held other subordinate positions. The antecedent position of the special assessors during 1869–70 and 1870–1 was that 53 had served as clerks, 24 had been ministerial officers, 9 were *zemindars*,[1] and 29 belonged to miscellaneous ranks. With a staff like this, so heterogeneous in its composition and selected without any reference to aptitude or qualification for this kind of work, what is surprising is, not that bribery and corruption existed, but that it was not much more extensive than it actually was. Even with such a staff it was noticed that with greater supervision and control some improvement was brought about. The Bengal Government issued a circular dated the 18th July, 1870, directing the district officers to test a percentage of the assessment made by the subordinate officers, and this check had visibly improved income tax administration.

On the whole the income tax of 1869–73 was a success from the financial and administrative standpoints. The Government made an intelligent and fairly successful effort to make income tax a more important constituent element in the tax system of the country than it had been in the past. That the tax had its shortcomings cannot be ignored. But these would have disappeared in course of time, if the tax had been put on a more stable basis. Its abolition, carried out in the teeth of the opposition of an experienced and able Finance Member, was a serious blunder. Subsequent events showed that an income tax in some form or other was needed in India to maintain financial equilibrium. A direct tax in some respects analogous to an income tax was revived not long afterwards, but in a form which had none of the redeeming virtues of a regular income tax. This was the licence tax or a tax on trades and dealings, which formed a common feature of Provincial budgets in India during 1878–86. The history of the origin of these taxes forms the subject-matter of the next chapter.

[1] It is stated in one of the Bengal Reports on the administration of income tax of this period that the *Zemindars* could not be induced to act as special assessors, for they disliked locomotion, and statements, returns and forms were an abomination to them.

CHAPTER VI

FAMINE TAXES

THE year 1871 forms a landmark in the history of Indian finance. In that year was inaugurated the system of decentralization in finance, of which the object was to bring home to the Provinces in British India their responsibility for works of a Provincial character. The Government of India proposed to transfer to the Provinces, with effect from the beginning of the financial year 1871–2, the following departments in which the Provinces were specially interested—Gaols, Registration, Police, Education, Printing, Roads, Miscellaneous Public Improvements and Civil buildings. To enable the Provinces to meet the expenditure caused by the transfer of these departments the Government of India granted an assignment of £4,688,711 from the central revenues, this assignment being less than the corresponding assignment for the same services in 1870–1 by £330,000. This assignment was to be regarded as permanent, unless some misfortune such as a serious fall in the opium revenue or a national disaster like war or famine occurred to disturb the budgetary equilibrium of the Government of India. The Provincial Governments were required to make good the deficiency in their revenue by taxes suitable to the local circumstances of each Province.

Decentralization of Provincial Finance, 1871.

In accordance with this scheme of decentralization considerable development of taxation took place in the Provinces. In Bengal the immediate effect of the scheme of decentralization was the passing of the District Road Cess Act.[1] This Act was imposed with a view to make

[1] B.C. Act X of 1871.

good deficiencies in the expenditure on roads, which arose from the inability of Provincial funds to continue their former scale of assignments. In accordance with the provision of the Local Rates Act [1] passed in the North-Western Provinces, the funds raised were carried to a General Provincial Fund out of which the proceeds were allotted, in the first instance, for expenditure in the district in which they were raised, any balance unspent at the end of the year being available for expenditure in the Provinces outside the district. Acts on similar lines were passed for Oudh and the Punjab.[2] The Presidencies of Bombay and Madras were also compelled to increase their Provincial resources by an extension of taxation.[3]

Decentralization Scheme of 1877–8.

The decentralization scheme inaugurated in the year 1871–2 was developed and improved in 1877–8. The system, as it was originally introduced, was found to be defective on account of its rigidity. While the Provinces were burdened with the management of the services the outlay on which continued to expand, they had only the fixed assignment from the Central Government with which to meet such growing outlay. To remedy this defect the Provinces were granted, in addition to the fixed assignments, the receipts from Excise, Law and Justice, and a few other minor sources of revenue which they could develop for their own benefit. The relief which the Central Government obtained by the development of this scheme of decentralization was £400,000 in addition to the sum of over £330,000, which represented the first-fruits of the Government's efforts at economy. This sum of £400,000 was to be obtained by the transfer to Provincial control of certain branches of revenue, by handing over to Provincial management certain heads of expenditure, and lastly by requiring that extraordinary works, which serve a chiefly local end, were in future to be maintained by local or Provincial funds.

As in the former period, the transfer of responsibility

[1] XVIII of 1871—*An Act for the Levy of Rates on Land in the N.W.P.*
[2] See Act XVII of 1871 for Oudh and Act XX of 1871 for the Punjab.
[3] *Vide* Bombay Acts I and II of 1871 and the Madras Town Improvements Act, 1871, and the Local Funds Act, 1871.

to the Provinces meant fresh taxation. The lead in this matter was taken by the Government of the North-Western Provinces which modified the operation of the Local Rates Act,[1] and imposed fresh burdens on the non-agricultural classes. Under the Local Rates Act of 1871, the funds raised could be spent in the first instance only in the district in which they were raised. This provision was now modified by Act VII of 1877, enabling the local Government to appropriate on account of Provincial railways and canals a portion of the existing rates on land.[2] The non-agriculturists were also called upon to bear their share of the burden, for they "were amongst those who benefited especially from the class of works which it was now proposed to transfer to the local Government." [3] The result of this proposal was the passing of Act VIII of 1877—An Act for the Licensing of certain Trades and Dealings in the North-Western Provinces.

The Genesis of the Northern India Licensing Act, Act VIII of 1877.

The proposal to tax the trading and commercial classes dates from the year 1871. Immediately after the inauguration of Lord Mayo's scheme of financial decentralization, there was introduced in the Indian Legislative Council on the 10th March, 1871, a bill for imposing a licence duty on trades and dealings in the North-Western Provinces. Under this bill the trades were divided into three classes, chargeable respectively with taxes of six, four and two rupees a year. The bill was, however, withdrawn on the 6th April, 1871, as the tax was not needed to restore financial equilibrium in the budget of the North-Western Provinces. In withdrawing the measure the Lieutenant-Governor of the North-Western Provinces observed that the revenue had been under-estimated and the expenditure over-estimated, in all amounting to over £100,000, exactly the sum which a licence tax was estimated to yield.[4] When again, in

[1] Act XVIII of 1871.

[2] Act VII of 1877—*An Act to amend the Law relating to Assignments from the General Provincial Fund established under the N.W.P. Local Rates Act*, 1871.

[3] See Colvin's speech, *Legislative Council*, 21st March, 1877.

[4] See his speech, *Legislative Council*, 6th April, 1871.

furtherance of the scheme of decentralization, additional funds were needed in 1877, the Government, true to their instinct, fell back upon the licence tax, and drafted a measure which in its essential features resembled that introduced in 1871.

The bill divided the whole body of traders into three classes. These classes again were subdivided into grades and the duty payable varied from Rs.64 to Rs.2. It was thought desirable to introduce gradations within the three main classes to improve the yield of the tax, and, further, to prevent the tax from pressing unduly on the poorer classes. It was laid down that the tax should not exceed 2 per cent. on the estimated earnings of the individual. The Select Committee, however, introduced several changes in the draft bill. Gradations within the classes were abolished as tending to complicate the administration of the tax, and only three rates of Rs.16, 8 and 2 respectively were fixed on the ground that taxation at the lower rate was quite sufficient. The maximum rate was payable by bankers, professional moneylenders, companies registered under the Indian Companies Act, 1866, and wholesale dealers, while a variety of miscellaneous occupations had to take out a licence on payment of a fee of Rs.8. Occupations not specifically mentioned came under the third class and paid a fee of Rs.2. It was originally intended that special notices should be served on individuals liable to take out a licence, but this provision was dispensed with in the amended bill, and power was taken to require returns from municipalities showing the number of persons chargeable with the duty.[1] The principle of a maximum levy of 2 per cent. was also done away with. The taxable minimum was fixed at Rs.200 a year.[2] It would thus appear that the Northern India Licence Act as finally passed was a very simple measure. It avoided all inquisitorial procedure, no returns of income were called for and so far as the richer classes were concerned the impost was very light indeed. The imposition was justified on the ground that as the non-agriculturists would benefit by

[1] Section 18, Act VIII of 1877. [2] Section 11, Act VIII of 1877.

local works they should be called upon to contribute towards the expenses of such works, just as the agriculturists contributed their share under Act VII of 1877.

Act VII of 1877 and the Northern India Licence Act—Act VIII of 1877—must be regarded as complementary to each other, as they were both necessitated to carry out a great financial reform, viz., enforcing Provincial responsibility for works undertaken for the benefit of local and Provincial interests. The counterpart of these measures in Bengal was the Public Works Cess Act[1]—a measure designed to raise additional funds by means of a cess on land. When the scheme of decentralization of finance in furtherance of which these local taxes were levied was developed in 1877–8, the question of taxation for meeting the cost of famines was reserved for future consideration. For some years before 1877 the Government of India had been contemplating the levy of a special cess on the *Zemindars*, in order to enable the Government to meet the emergency expenditure caused by the outbreak of famines. In 1866 the Commissioners appointed to inquire into the famine in Bengal and Orissa suggested the institution of some system of local taxation by which the *Zemindars* of each neighbourhood, best able to test the reality of local distress, should be made to bear the burden of local famines before recourse was had to general taxation.[2] On the 7th June, 1870, the Government of India sent out a circular to the Provincial Governments inviting their opinion on the suggestions made by the Commissioners. The Provincial Governments unanimously condemned the proposed special tax on the landowners alone. The Government of Bombay described it as " an utterly illogical course of proceeding." The Government of Bengal repudiated the contention of the Commissioners that any special obligation attached to the *Zemindars* in the permanently settled areas to maintain the poor of the district, for " to impose upon them solely

Famine Taxes —Proposed Special Tax on Zemindars.

[1] Act II B.C. of 1877—*An Act to provide for the Levy of a Cess for the Construction, Charges, and Maintenance of Provincial Public Works.*

[2] *Vide* para. 68 of the Report.

such a tax as that which is now under consideration to the exemption of the general community from such charges would be open to all the objections to exclusive taxation on a special class not fairly liable to it."[1]

A special tax on the *Zemindars* having been considered inexpedient, it became necessary to take recourse to wider measures. On the 16th August, 1877, the Government of India addressed a letter to the Secretary of State on the subject of famine taxation, and pointed out the necessity of treating expenditure for famine relief as an ordinary obligation. In the light of past experience they calculated the yearly average cost of famines in loss of revenue and actual expenditure at £1,500,000 and proposed to increase the annual resources of the country to this extent by a licence tax on the non-agricultural and a special cess on the agricultural classes. It was notorious, argued the Government of India, that the non-agricultural classes, beyond contributing their small share of the customs duty and the salt tax, did not sustain their fair share of the burden of the cost of administration and defence of the country. It was proposed to take the North-Western Provinces Licence Act as the model, to introduce a bill in the Indian Legislative Council on similar lines applicable to all Provinces which had no independent Legislatures and to supplement the measure by local legislation in the Presidencies of Madras, Bombay, and Bengal. The Government of India concluded with the observation that the introduction of such local measures would be beneficial in helping to connect the tax in the minds of the people more directly with the undoubted responsibility which rested upon them to provide for their own support and well-being, and to disabuse their minds of the prevalent impression that local wants were always to be supplied at the expense of general revenues. Thus originated the Provincial licence taxes, viz., (1) the Northern India licence tax—Act II of 1878; (2) the Bengal licence tax—Act I

[1] *Vide* Letter from R. Thompson to the Secretary to the Government of India, Home Department, dated the 2nd February, 1871; also letter from Commissioner, Northern Division, Bombay, 2nd November, 1870, letter from Government of N.W.P., No. 1009 of 26th September, 1870.

B.C. of 1878; (3) the Bombay licence tax—Act III B.C. of 1878; and (4) the Madras licence tax—Act III M.C. of 1878.[1]

These licence taxes borne by the trading community were imposed along with cesses on agricultural classes. The agriculturists and the traders were singled out from the whole community for a variety of reasons. In the first place it was argued that the agriculturists were among the first to suffer from actual visitation of famines. They should, therefore, contribute to their own protection. In the second place the trading classes, except the European commercial community, did not bear their fair share of the expenses of the State; and lastly, though the trading classes were among the first to suffer when a famine occurred in their own Province, they derived a benefit from such visitations when famines broke out in other parts of India.

Tax on Agriculture and Trade.

In Bengal, as there was already a cess on land in the shape of the road cess and the public works cess, what was needed was only a licence tax. In the North-Western Provinces, it is true there was already a licence tax, viz., Act VIII of 1877, but as this tax was not sufficiently graduated its yield was insufficient. It was therefore necessary to develop this tax and also to supplement it by a cess on land. In Oudh and in the Punjab both the licence tax and the cess were needed, while in the Central Provinces the old *Pandhari* assessment enabled the Government to reach the commercial and trading classes, legislation therefore being needed only with regard to land. In the Bombay and the Madras Presidencies the special contribution of the agricultural community took the shape of an increase

[1] The titles of the Acts are given below:

(*a*) *An Act for the Licensing of Trades and Dealings in the Punjab, the N.W.P. and Oudh.*

(*b*) *An Act for the Licensing of Trades, Dealings and Industries within the Territories, subject to the L.G. of Bengal.*

(*c*) *An Act for the Licensing of Trades, Dealings and Industries in the Presidency of Bombay.*

(*d*) *An Act for Licensing Trades, Dealings and Industries in the Presidency of Madras.*

in the salt duty from R.1 13 annas a *maund* to Rs.2 8 annas. The trading classes were taxed by the Licence Acts. The sum of approximately £1½ million required for famine relief was raised from three different sources. A sum of £400,000 was obtained by transferring to the Provinces the cost of administration of the several departments. New cesses on land were estimated to yield £500,000, while the licence taxes were expected to yield something like £700,000. We shall now proceed to consider the operation of the various licence taxes beginning with the Act for the Licensing of Trades and Dealings in the Punjab, the North-Western Provinces and Oudh.[1]

Act II of 1878 in the Punjab, the N.W.P. and Oudh.

The licence tax of 1878 imposed in the Punjab, the North-Western Provinces and Oudh was merely a development of a similar tax already referred to, passed in the previous year. The preamble to the Act stated that the tax was necessary to effect a permanent increase of revenue, in order to provide means for defraying the "public expenditure from time to time incurred and to be incurred for the relief and prevention of famine in British India." The commercial classes were brought under taxation on the supposed ground that while their contributions to the maintenance of government were very small, they derived considerable profit in times of famine as engaged in trading operations. Sir John Strachey, in justifying the exemption of the professional and other classes from the tax, observed[2] "the professional classes and those who depend on fixed incomes for their support, although they suffer from the high prices caused by famines, are seldom the recipients of actual relief from the State; under no circumstances do they derive any advantage from famine when it occurs." This statement, that traders derived an advantage from famines, was evidently based on a false premise; for the only traders who derive any substantial advantage from famines are the grain dealers. The other traders, far from receiving any profit, are among the first to suffer from trade

[1] Act II of 1878.
[2] *Vide Report of the Select Committee*, 9th February, 1878.

depression and the resulting loss of custom and diminution of profits. It was therefore an act of injustice to single out the trading community for extra taxation precisely at a time when its margin of profit was bound to fall. As a matter of fact, as we shall see later on, a considerable amount of the discontent to which the Provincial licence taxes gave rise, was based upon the inequitable distribution of the burden of taxation.

The draft bill proposed to fix the maximum fee at Rs.200 only, but as an objection was raised that the tax let off the richer classes lightly the maximum was raised to Rs.500 a year. The Act divided the licensees into three classes, each class again being subdivided into grades. The basis of classification was the nature of occupations and the probable income of the assessees. The first class included, among others, companies registered under the Indian Companies Act, 1866, owners of cotton screws, persons keeping shops for the sale of European goods, sugar and tea manufacturers, etc. There were four grades of persons in the first class, paying according to their incomes fees of Rs.500, 200, 150, and 100 respectively. The second class included a variety of heterogeneous occupations, e.g., cloth sellers, druggists and dealers in elephants, and also persons specified in the first class whose incomes were not so large as to warrant their inclusion in that class. There were four grades in the second class, viz., those paying taxes of Rs.75, 50, 25 and 10 a year. The third class included occupations not specified in the first two classes and was divided into three grades paying Rs.5, 2 and R1 respectively. Any person could have the fee charged against him remitted or reduced, on proving that the incidence was higher than 2 per cent. on his annual earnings.[1] Under section 26 of the Act the Provincial Government were empowered to exempt any person whose net annual income was less than such sum as the Provincial Government might from time to time fix. It was the intention of the Government to exempt persons drawing less than Rs.100 a year. It will be noticed that the lowest

[1] Section 13, Act II of 1878.

fee payable was one rupee. The Act at the same time fixed the rate of 2 per cent. as the maximum levy. Clearly, it was the intention of the framers of the Act to leave a discretion in the hands of the executive who could reduce the demand to one rupee in the case of persons drawing Rs.100 a year. The Act came into force on the 1st May, 1878. Contrary to public expectations the minimum taxable income was fixed at Rs.200. This was done to avoid hardship to traders and dealers, who had suffered much from the prevailing high prices, and to relieve the revenue officers from the very heavy work thrown upon them in connection with the work of assessment and the disposal of numerous objections that were bound to crop up.[1]

The Bengal Licence Tax, Act I of 1878.

The question which confronted the Bengal Government at this time was the method by which the Bengal quota of famine charges was to be raised. On behalf of the Government of Bengal, Mr. Mackenzie pointed out that it was not possible to raise the necessary sum by indirect taxes, such as the salt duty or the establishment of a tobacco monopoly, which had been suggested in some quarters. There were some who even suggested a marriage tax as one of the means of relieving Bengal of her financial difficulties. Mr. Mackenzie rejected such a suggestion on the ground that a marriage tax could only be worked through the police, and was besides open to objection as affecting the Mohammedan population.[2]

These expedients being rejected, a licence tax was decided upon as in the North-Western Provinces. The observations of Mr. Mackenzie, the official exponent of the bill in the local Council, justifying the imposition of fresh taxes are worth quoting. He observed:

"These taxes are not required by us to bolster up unholy war or carry carnage through a neighbour's land. We do not

[1] See letter No. 113 A. of the 29th March, 1878, from Government of the N.W.P. to G. of I.

[2] *Vide* Mackenzie's speech, *Bengal Legislative Council*, 29th December, 1877.

wring from toil its tribute to satisfy a sovereign's lust or raise in far-off capitals memorials of conquest. We seek to save the lives and not to filch the earnings of the poor, and we demand from the people of Bengal the means of warding from their doors that famine spectre that has slain already so many of their brethren and may, for aught we know, be knocking at their own homes in early future."

Generally speaking, the Act was similar in its structure to the Licence Act for the North-Western Provinces, and only such changes were made as the local circumstances of Bengal necessitated. The taxable minimum was originally fixed at Rs.100 a year, but was subsequently raised to Rs.250.[1] The principle of a 2 per cent. levy finds a place in the Bengal Act and, as in the North-Western Provinces, it was the ultimate standard to which the assessee might appeal if he disputed the rough classification of the Collector. Inquisitorial inquiries were avoided by the provision which laid down that no evidence could be called for by the Collector, except at the instance of the tax-payer who might feel aggrieved by the classification. This procedure was also borrowed from the Northern India Licence Act. But one cannot proceed very far without noticing certain fundamental differences between the Bengal and the Northern India Licence Acts. In the first place the tax in Bengal differed from that in Upper India, in so far as the Bengal Act laid down two different schedules of taxes, the one applicable to Calcutta and the other to the rest of Bengal. The Calcutta rates were as follows:

			Rs.
Class	I	1st Grade	500
		2nd ,,	200
	II		100
	III		50
	IV		25
	V		12
	VI	1st Grade	5
		2nd ,,	2
		3rd ,,	1

[1] *Vide* letter, Secretary, Finance Department, G. of I. to the Government of Bengal, 12th September, 1879.

The Bengal (except Calcutta) rates are given below:

		Rs.
Class I	1st Grade	500
	2nd „	200
II		100
III		50
IV		20
V		5
VI	1st Grade	2
	2nd „	1

It will be evident that so far as the first three classes were concerned the two schedules were identical, but as regards the remaining grades the Calcutta rates were on the whole higher. Not only were these rates higher in Calcutta than in the rest of Bengal, but the Calcutta schedule brought under taxation pleaders, attorneys, physicians, etc., who were exempted in the country districts. Obviously, this discrimination against Calcutta professional men was made on the supposition that they earned larger incomes than their colleagues in the country. This sort of reasoning was, however, equally applicable to the Calcutta trading classes, but so far as they were concerned no differentiation was attempted in the higher grades.

In the second place another difference is to be found in the fact that while in the Punjab, the North-Western Provinces, Oudh, the assessment rolls were prepared by the *Tahshildars* on information supplied by *Patwaris* and *Quanungoes*, in Bengal it was found necessary to utilize as far as practicable the agency of municipal or other local bodies. The Act empowered the Collector to require the Municipal Commissioners and the *Panchayet* of any Union constituted under the Bengal Act V of 1876 or any village *Panchayet* under Bengal Act VI of 1870 to furnish returns of persons liable to take out a licence. These local bodies were further required to pay to the Collector, within a stipulated period, a sum calculated on such returns, after such deductions for necessary expenditure, as might be agreed upon.[1] The Lieutenant-Governor of Bengal ex-

[1] Sections 27 and 28 of Bengal Act I, 1878.

plained in the Legislative Council that the intention was to fix a certain amount which a municipality or other local body should pay, and then to give such bodies the whole benefit of any sum which they might collect in excess of the minimum sum on which the contract was based. It is needless to point out that an arrangement like this which in fact urged the municipalities, though indirectly, to collect as much as they could, served to make the tax unpopular with the people. It would have been far more preferable if the local bodies had been reimbursed for their trouble and expense in collecting a Provincial tax by a certain percentage on their collections. A duty was imposed on the municipalities by statute, but no provision was made by which they could be compensated for the expenses incurred in discharging this statutory obligation.

The Bombay Act divided the licensees into fifteen classes. The maximum fee payable was fixed at Rs.200 and the minimum at Rs.2 a year. Both the maximum and the minimum were thus different from those fixed for Northern India and Bengal. No taxable minimum was directly provided for, but as the 2 per cent. provision was incorporated in the Act [1] this meant a taxable minimum of Rs.100 a year.

Bombay Licence Tax, Act III of 1878.

The Madras Act divided the tax-payers into twelve classes and fixed the minimum taxable income at Rs.200. The highest tax payable was Rs.800 and the lowest was Rs.4. The peculiar feature of the Madras tax was that the assessees were divided into classes according to their income, and the tax was so adjusted as to make the 2 per cent. rate payable by the poorest man included in a particular class. Thus persons whose annual earnings were adjudged to be Rs.40,000 or upwards paid the maximum fee of Rs.800. Persons whose incomes were estimated at Rs.30,000 a year or more, but at less than Rs.35,000, paid a fee of Rs.600, and so on throughout the entire list.[2]

Madras Licence Tax—Act III of 1878.

The question of providing funds for meeting famine

[1] Section 12, Bombay Act No. III of 1878.
[2] Schedule to the Madras Act No. III of 1878.

expenditure in the Central Provinces is intimately bound up with the *Pandhari* tax.[1] No separate levy in the shape of a licence tax such as was necessary in other Provinces was called for in the Central Provinces, as the old *Pandhari* tax dating from the Mahratta times already provided a fitting instrument for the purpose. The vicissitudes through which this tax passed from 1860 onwards must, however, be narrated first before we proceed to discuss what part this ancient tax played in the 'eighties of the last century in providing funds for the relief of famines.

The *Pandhari* Tax in C.P. 1860–7.

In Mahratta times the tax was levied on artisans and petty shopkeepers, and in fact upon all persons not engaged in agriculture. Generally speaking, absolute inability to pay was the only ground for exemption. The tax was retained by the British Government on the annexation of Nagpur. When income tax was first imposed in 1860, the *Pandhari* assessment was allowed to stand and was collected simultaneously with it. It will be recalled that Wilson proposed to supplement the income tax by a licence tax designed to reach incomes below Rs.200 a year. In furtherance of this idea the Licence Tax Act was passed reaching incomes between Rs.50–200 a year, though it was repealed in 1862.[2] During the few months of 1861–2, in which the licence tax was in operation, the *Pandhari* tax was so modified as to fall on incomes between Rs.25–50 a year.

There were therefore in this part of the country, for a very short period, three different taxes fitting into one another. The *Pandhari* was payable on incomes between Rs.25–50. The licence tax began where the *Pandhari* ended, taxing incomes between Rs.50–200, while the income tax brought under contribution persons in receipt of higher incomes. Simultaneously with the abolition of Wilson's licence tax in 1862, the taxable minimum for income tax was raised to Rs.500. The void thus created by the raising

[1] The Mahratti word is "*Pandhri*" meaning white. It is opposed to "*Kali*" or black, the technical name given to land revenue—*Vide Reports on Taxation in British India*, 1872, p. 413.

[2] See Chapter III.

of the taxable limit was filled up in the Central Provinces by the *Pandhari* tax. In 1867 the minimum taxable income for the *Pandhari* was raised to Rs.75 a year.[1]

In that year the imposition of the tax, which had so long been based upon mere executive orders, was for the first time regularized by the passing of Act XIV of 1867. The preamble to this Act pointed out the ancient character of the tax, and laid down that it was "assessable on all persons not engaged in agriculture." The Act empowered the Government of India to extend the tax which had hitherto been confined to Nagpur and Sambalpur to other districts in the Province. The maximum rate of the tax was fixed at 2 per cent. per annum, with this reservation, that the tax payable by any person was not to exceed Rs.500.[2] The Act also empowered the Chief Commissioner of the Central Provinces to fix the minimum taxable limit, and to make rules consistent with the Act with the previous sanction of the Governor-General.

Pandhari Tax 1867–77.

With the imposition of the licence tax in 1867 and the certificate tax in 1868, the *Pandhari* was utilized on each of these occasions to bring under taxation persons in receipt of incomes below Rs.200 and 500 a year respectively. Up to the year 1868 the receipts from the *Pandhari* tax, which amounted to £35,560 during 1867–8, used to be credited entirely to the revenues of the Central Government. In 1868, on account of the insufficiency of local funds and in view of the many urgent demands upon them, half the receipts from the tax were surrendered to local funds, the other half being credited as usual to the revenues of the Government of India. In 1869 the other half of the receipts were similarly surrendered to local funds, in view of the restrictions imposed by the Government of India upon the power of the municipalities to levy octroi. The restriction thus imposed was withdrawn in 1870–1, but the *Pandhari* tax, or any portion of it, was not resumed for the central revenues. In 1871 the taxable minimum for

[1] *Papers relating to Provincial and Local Finance* (compiled in the Finance Department of the Government of India, Calcutta, 1876), Chapter IX.
[2] Section I, Act XIV of 1867.

the *Pandhari* was raised from Rs.75 to Rs.100 a year. On the reimposition of the income tax and the successive rise in the taxable limit that followed, the scope of the *Pandhari* assessments was widened so as to bring under taxation incomes exempted by the Government of India. On the abolition of the income tax in 1873 the minimum taxable limit for the *Pandhari* was raised to Rs.250.[1]

The following table shows the scale of the tax, the number of persons assessed and the receipts during 1876–7:

Class.	Amount of Tax.	Income on which Payable.	Number of Persons Assessed.	Yield.
	Rs.	Rs.		Rs.
1 . .	3	250–350	10,132	30,396
2 . .	4	350–450	2,890	11,560
3 . .	5	450–550	2,532	12,660
4 . .	6	550–650	1,181	7,086
5 . .	7	650–750	679	4,753
6 . .	8	750–850	608	4,864
7 . .	9	850–1,000	393	3,537
8 . .	1 p.c.	1,000 and above	2,794	69,839

When in connection with the decentralization scheme the question of famine taxation was being discussed in 1877 for other parts of India, it became quite clear that the *Pandhari* tax would enable the Central Provinces Government to bring the commercial classes under taxation. Accordingly, on the 31st December, 1877, the Additional Secretary to the Government of India, Finance Department, addressed a letter to the Chief Commissioner, Central Provinces, intimating that the Government of India would be prepared to sanction proposals for enhancing the rate of *Pandhari* assessments from 1 to 2 per cent. in some or in all the classes and to lower the limit of exemption, if necessary, but the Government were not prepared to pro-

[1] *Papers relating to Provincial and Local Finance* (1876), Chapter IX, paras. 147–8.

pose fresh legislation for raising the maximum payable by the richer classes. In reply the Chief Commissioner proposed to lower the limit of exemption to Rs.150 and to enhance the rate to the maximum of 2 per cent. permissible under Act XIV of 1867. These two modifications, it was estimated, would increase the yield to Rs.256,856, giving an increase of Rs. 112,000 over the yield for 1876–7. These proposals were sanctioned by the Government of India and the new schedule of taxes took effect from the financial year 1878–9.

CHAPTER VII

FAMINE TAXES (*continued*)

We have considered in the previous chapter the details of local legislation passed in the various Provinces with a view to provide funds enabling the Government of India partially to meet the recurring cost of famines. We have seen that the licence tax took the shape of a 2 per cent. levy on the income of the trading classes. Strictly speaking, the charge imposed was not a licence tax in the ordinary sense of the term. For a licence tax, properly so called, prohibits the carrying on of any occupation, unless and until the tax is paid, and admits of no exemption of incomes. As soon as the principle of exemption of a minimum income was introduced, the tax ceased to be a licence and approximated to a rough income tax. The licence tax, while it resembled an income tax from this point of view, was marked out from a true income tax in so far as the fundholder, the salaried servants and professional men were exempted from its operation. It was, in fact, a hybrid tax possessing some characteristics common to both.

Criticism of the Licence Tax.

Then, again, the fundamental assumption on which the tax was based was erroneous. The Bengal Chamber of Commerce protested against the unequal operation of the tax, and in the course of a letter to the Secretary of State vehemently dissented from the view propounded by the Government that trades and industries generally benefited from famines,[1] and therefore they should pay a large proportion of the annual tribute demanded by the State. This protest had no effect on the Government, which

[1] *Vide* letter of the 23rd March, 1878.

persisted in the view that the trading classes were lightly taxed. In his speech introducing the Financial Statement for 1882–3 the Finance Member remarked that the trading classes, " who perhaps more than any others have benefited by the British rule in India pay so little has long been recognized as a blot upon the Indian fiscal system." The Madras Chamber of Commerce took strong exception to this statement and retorted that the Finance Member overlooked the fact that the European officials in India were remunerated " on a scale which has no parallel in any other part of the world." The Chamber admitted that the trading classes ought to contribute their quota, but it refused to acquiesce in the exemption of professional men and officials, " some of whom are in receipt of incomes that in these days of fine margins most merchants may well envy." [1]

Equally unsatisfactory was the manner in which the tax was assessed. The work was entrusted to subordinate revenue officers engaged in land revenue collection. As no such agency existed in Bengal, it became necessary to create a new organization for the purpose, except in so far as the services of municipalities and other local bodies could be utilized. Each district was divided into a number of circles and placed in charge of a Circle Officer, whose duty was to assess and collect the tax. There were 264 Circle Officers during 1878–9 in the whole of Bengal (excluding Calcutta). These officers had to visit in six or seven months about 154,634 villages.[2] In towns constituted as municipalities or in rural areas constituted as Unions, the assessments were made by the municipal committees or Union *Panchayets.* In these areas, therefore, the Circle Officer had no hand in the work of assessment, as the assessment list was returned direct to the Collector of the district. In Calcutta the assessment work was entrusted to the Chairman of the Municipal Corporation who had to discharge at this period, in addition to his civic duties, the function of the

[1] *Vide* letter to the Finance Member, Government of India, 5th April, 1882—*Proceedings of the Bengal Chamber of Commerce.*

[2] *Vide Bengal Licence Tax Administration Report,* 1878–9.

Commissioner of Police. It is true that the Chairman was aided in his work of assessment by a number of Circle Officers and enumerators, but neither the Chairman of the Calcutta Corporation nor the Collectors of districts could afford much time to supervise minutely the operation of the licence tax without neglecting their other and more important duties. They had, therefore, to appoint a deputy or a vice-chairman who appointed other deputies, until the working of the Act was left to ordinary assessing *sircars* (bill collectors). Commenting on this feature of licence tax administration, Mr. Yule, the President of the Bengal Chamber of Commerce, observed: "Just as the duty of working the Act was jerked down the different grades of functionaries from Collectors to *sircars*, the lists which the latter prepared were jerked up the same grade until they reached the Collector who approved the lists without hearing anything about them."

The work of assessment was very difficult indeed, as there was nothing tangible on which to base even a rough estimate of an assessee's income. As no returns of income could be called for, the subordinates were left to form a rough estimate of the tax-payer's means as best they could. The dwelling of the assessee was visited, a mental note was taken of its condition, the tax-payer's style of living, the value of his untensils, and even the aspect of his face scrutinized in the hope of getting some rough estinate of his wealth. Lucky indeed was a Collector in the North-Western Provinces who found an elephant tied up near the house of one assessee, for he, at any rate, had obtained something substantial to build upon. But all Collectors could not hope to be so fortunate.

This uncertainty was not peculiar to any particular Province, for the work of assessment proceeded on much the same lines in every part of the country. An an illustration of the manner in which the licence tax was administered, we may instance the case of Bengal during 1878–9. In that year the total demand for the tax was Rs.4,822,851, out of which only Rs.2,665,753 was collected and a sum of Rs.2,026,811 was remitted and Rs.130,287 became

irrecoverable by lapse.[1] Again, in Calcutta from the beginning of the financial year 1878 up to the 31st December, 1878, 1,519 petitions of objection were disposed of. Of these 612 were from persons who had been assessed in the first grade liable to pay a tax of Rs.500. Upon appeal only 14 of these were upheld. Out of the total number of 1,519 petitions, only 137 assessments were upheld.[2] Since no returns could be called for, the tax could only be administered by guess-work. Remissions were given on a large scale, and the collection of revenue was disproportionately small as compared to the original demand. One local officer in the North-Western Provinces pointed out that in estimating traders' profits "only the most distant approach to the vaguest conviction" was all that was possible. Persons from whom information might be sought for regarding income were divided into three classes by this officer. In the first class came those who did not know and did not profess to be able to give any information. In the second there were those who did not know, but volunteered endless information as inaccurate as it was copious. Thirdly there were others who did know, but would not tell. But the fourth class of men, namely, those who did know and were willing to tell, were rare indeed.[3]

In particular, a section of the Indian public felt aggrieved at the provisions of the Act, which made each member of a joint Hindu family liable to take out a separate licence, in respect of any trade or dealing in which he was engaged. In this matter there was a discrimination as between the liabilities of partnerships and joint Hindu families. Partners were assessed to only one tax jointly,[4] while the members of a joint Hindu family were made separately liable. There was, of course, some justification for this differential treatment, for the members of a joint Hindu family might live widely apart from one another and pursue different occu-

[1] Resolution of the Government of Bengal dated the 11th November, 1879, on the administration of the licence tax, 1878–9.

[2] *Vide* speech by Mr. George Yule, President of the *Bengal Chamber of Commerce*, at the half-yearly meeting held on 18th February, 1879.

[3] *Licence Tax Administration Report*, N.W.P., year ending 31st December, 1879.

[4] Section 13, Bengal Act I of 1878.

pations. One member might be engaged in trade, another a lawyer, while a third might be a broker. Obviously, in these circumstances it would have been unfair to charge one lump sum on the family. At the same time it must be remembered that in rural areas, where individuals belonging to families of limited means were thus engaged in varying occupations, this practice of charging individuals separately added to the burdens of the tax and made it unpopular.

The European commercial community also, particularly in Bengal, had its own peculiar grievance against the provisions of the Act, which in many cases compelled it under heavy penalties to take out a licence in more than one district. The jute mill companies, for instance, had their head-quarters in Calcutta, while their mills and factories were situated outside Calcutta. Under the provisions of the Act, companies like these had to take one or more licences in the districts in which the factories were situated and another for their head-quarters in Calcutta where the profits were distributed.[1] Again, merchants whose head-quarters were in Calcutta, but who had buying agencies scattered through the whole of Bengal, had to take out as many licences as they had agencies in separate districts. Of course, it was quite open to them to prove that they had no earnings in these areas where they had agencies, and to apply for a refund of the tax. But the law required that the tax must be paid on demand on pain of a penalty of thrice the amount of the tax.[2] The railway companies also were hard hit, for they had to pay this tax for every district through which their lines passed, and in their case it was not open to them to prove that they had no earnings in these districts. Double, triple and in many cases quadruple taxation took away what little justification there might have been for the imposition of a licence tax, which was originally intended to be a light impost on the trading and commercial classes. An income tax based on actual profits of companies would have been far more

[1] Section 8, Bengal Act I of 1878.

[2] *Vide* section 21 of the Bengal Licence Act. Such provisions occur in the other Provincial Acts as well, e.g., section 15 of the Bombay Act III of 1878, section 19 of the Madras Act III of 1878.

equitable and uniform in its operation than a system of taxation avowedly based on guesses and conjectures.

The unsympathetic manner in which the tax was administered added to the hardships of the people and increased the resentment against the tax. The subordinate officials were not slow, in many cases, to utilize the opportunity in satisfying their personal grudge. When the assessment list was complete, it had to be hung up on the notice-boards of *thanas* (police stations). Thirty days' time was allowed for instituting an appeal and, if there was no appeal and the tax was not paid within sixty days of the publication of the list, the defaulter was liable to a fine.[1] In addition to the fine, a fee of R.1 was charged "for giving notice that a fine was imposed," and the assessee was further informed that if the tax, the fine and the fee were not paid within seven days distraint would follow. Mr. Yule, the President of the Bengal Chamber of Commerce, referring to the stringent administration of the tax, pointed out that these "three-barrelled messages were fired off into many an open door" and caused extreme dissatisfaction. He observed that the misery the Act was causing might lead one to suppose that the Government had been studying the art of taxing in some Turkish pashalic.[2]

In many cases the tax was imposed even upon barbers, washermen, and persons who lived from hand to mouth. The Provincial licence tax of 1878 descended very low in the scale of incomes and was collected with far more rigour than many of the previous direct taxes. This is apparent from the fact that while the all-India licence tax of 1867–8 yielded a sum of Rs.1,700,000 in Bengal, the Provincial licence tax of 1878–9 on the other hand, with its exemption of officials and professional classes, yielded more than Rs.2,650,000.[3] The Commissioner of the Burdwan Division observed as follows in 1878–9: "The burden of the Bengal licence tax falls with particular severity upon the lower

[1] Section 15, Bengal Act I of 1878.

[2] *Vide* his speech, 30th May, 1879—*Proceedings of the Bengal Chamber of Commerce.*

[3] *Vide Bengal Report on Licence Tax Administration,* 1878–9; also Fawcett, *Indian Finance,* p. 127.

classes, who live from hand to mouth and are unprepared to meet any unusual charge without dispensing with some necessary." In Calcutta the feeling against the tax manifested itself during 1878–9 by means of a strike amongst the *bhistis* (water carriers) and *nalbands* (farriers). The carters, who were assessed at Rs.5 a cart, also declared a strike, with the result that their assessment was reduced to R.1. The vernacular newspapers of the day in Bengal took upon themselves the task of voicing the popular discontent. The *Hindu Ranjika* of the 4th December, 1878, said: "Like fishermen, the assessors drag both large and small fish into their nets." The *Sulabh Samachar*, in its issue of the 7th December, 1878, commented that the licence tax was a permanent source of revenue and equally a permanent source of distress to the people. The Indian and European communities, with a unanimity rare on other occasions, wholeheartedly combined in condemning the tax. The Bengal Chamber of Commerce noticed with regret that the time which was wasted by the Government in muzzling the vernacular Press and in administering the Vernacular Press Act was not more profitably utilized in framing judicious rules for assessing the people under the Licence Act. The President of the Chamber at its half-yearly meeting on the 18th February, 1879, remarked that the licence notices had a wider circulation than native newspapers, and owing to the manner of their distribution were much more likely to generate sentiments of disloyalty.[1]

The discontent was as strong in other parts of India as in Bengal, but owing to the fact that public opinion, either Indian or European, was not so well organized its manifestation was less vocal. The Report on the operation of the Northern India Licence Tax for the year ending 31st December, 1879, observed that the tax no longer touched the great majority of the people who spoke most bitterly about the income tax; the great majority who paid the tax were sober traders not ready to fight. It further assured

[1] *Proceedings of the Bengal Chamber of Commerce*—Half-yearly meeting, 18th February, 1879.

the Government with some amount of satisfaction that, inasmuch as the tax was paid by the comparatively uninfluential portion of the population, any discontent that might continue to exist was utterly unworthy of attention from the political point of view. The Secretary to the Government of the North-Western Provinces and Oudh was of opinion that the tax was regarded with as much discontent and disaffection as the people were capable of showing, but there was no cause for alarm or anxiety.[1]

In the Punjab the feeling against the tax was largely due to the fact that it descended too low upon people who were suffering from scarcity and high prices. The Secretary to the Financial Commissioner was of opinion that the agriculturists as a class regarded this tax with a feeling akin to satisfaction, inasmuch as it was paid by the non-agriculturists,[2] but this feeling was very much shaken in some districts by the assessment of agriculturists as traders when they happened to hire out their carts and camels or to sell milk. In Surat, where the assessments on many persons were much too high during 1878–9, riots broke out, which were speedily suppressed.[3]

Not infrequently the licence tax exercised a prejudical effect on the people's desire to work. Cases are on record of owners of boats accustomed to trade, laying up or selling their boats in order to avoid the payment of the tax.[4] Again, it was noticed that the licence tax had a tendency to discourage the registration of bonds and other documents. When all other evidences failed, a registered document was the one tangible thing on which the assessor could rely. The document could easily be found in the public registration office. Many persons who had been occasional money-lenders thought it prudent to withhold the registration of their bonds for money advanced, as the document might be used as evidence against them for licence tax

[1] *Vide* letter from C. Robertson, Secretary to the Government of the N.W.P. and Oudh, dated the 11th February, 1879, to the Secretary, G. of I., Finance Dept.

[2] *Vide* letter from the Secretary to the Financial Commissioner of the Punjab to the Secretary, Punjab Government, 6th May, 1879.

[3] *Licence Tax Returns of the Bombay Presidency*, 1878–81–82.

[4] *Bengal Licence Tax Administration Report*, 1881–2.

assessment.[1] The indirect effect of this tax in encouraging litigation should not also be ignored.

The District Officers complained that, if they wanted effectively to supervise the work of licence tax assessment, they found very little time left for other and more important duties. Accordingly, a suggestion was put forward in some quarters that the assessment lists prepared once should be acted upon for some time to come, and that the Government should accept the *status quo* with as few exceptions as possible. The work of assessment was so heavy that there was a danger of the entire revenue administration being "clogged with the dust of the assessee hunt." A member of the Board of Revenue, North-Western Provinces, remarked in 1878: "The flower of the service must no longer spend the precious hours of their cold weather tour in groping through the dingy intricacies of fœtid lanes ferreting out possible tax-payers. This has been done once and this should be once for all." It will be recalled that, in 1861 and 1862, a device of this nature was adopted to relieve the congestion in administration. On this occasion, however, the Government did not find it practicable to adopt it.

The Proposed Extension of the Licence Tax.

The licence taxes introduced in 1878 remained in force till 1886, when they were abandoned in favour of an all-India income tax. The history of the intervening years is largely the history of the attempt of the Government of India to make the tax less burdensome to the poorer people and more equitable in its operation, first by raising the exemption limit, and secondly by bringing under taxation the professional, salaried and landed classes. The Government succeeded in their first object in 1880, when the minimum taxable limit was raised in all the Provinces to Rs.500. But all attempts to bring the exempted classes under taxation proved unavailing. The conduct of the Government during 1878–80 was throughout marked by

[1] *Bengal Licence Tax Administration Report*, 1881–2—opinion of the Commissioner of Chittagong Division; also *Report on the Operation of the Licence Tax, Northern India*, 1879.

vacillation, which was all the more regrettable in face of the serious exchange crisis and the resulting financial difficulty with which they were confronted. Twice during this period the Government went to the length of formulating concrete proposals for the taxation of officials and the professional classes, but on both these occasions the measures were withdrawn.

The first modification in the licence taxes was made in Bengal, by means of an executive order. By a telegram dated the 14th September, 1879, the Government of India raised the taxable minimum in this Province to Rs.250 a year. This step was taken to relieve the distress of the people due mainly to flood and other causes in Eastern Bengal. The result of this modification was to remit a claim of Rs.955,820, or nearly one-third of the gross demand. The reduction in the number of persons liable to taxation was, however, more than in proportion to the amount of remission, as the vast majority of the tax-payers belonged to the lower grades. Over 550,000 persons out of a total number of 740,432 assessees were relieved from taxation.

The Government of India had realized that there was considerable justification in the criticism that had been levelled against the licence tax, on account of the exemption of certain classes from what was justly regarded as an emergency levy. Accordingly, during the very first year of the operation of the tax in July, 1878, they recommended to the Secretary of State that the tax should be extended to salaried employments and professions at the rate of 1½ per cent., in order to remove, as far as possible, the reproach that the poorer classes were being unduly burdened. It will be remembered that the maximum licence tax in the Presidency of Madras was Rs.800, in Bengal Rs.500, and in Bombay Rs.200. It was calculated that if a tax was imposed at the rate of 1½ per cent. per annum on the salaries of the Governor-General, the Commander-in-Chief and the Governor of Provinces, the amount that would be payable by them would far exceed the highest fee payable in any of the Provinces under the provisions of the existing

Licence Acts. Leaving out of consideration these high officers of State, it was ascertained that the highest sum then payable as salary to a Government servant was Rs.50,000 a year. A tax at the rate of $1\frac{1}{2}$ per cent. per annum on this sum amounts to Rs.750. It was accordingly proposed to increase the maximum fee payable in Bengal and Bombay to Rs.750 by adding one grade in Bengal and two in Bombay. The Secretary of State agreed to these proposals and conveyed his sanction to the Government of India in November, 1878.[1]

The Proposal Withdrawn.

But nothing tangible came of these proposals. The Government of India argued that, as the finances were in a bad way, more drastic measures were needed than the mere extension of the licence tax to some of the exempted sections. The fall in the gold value of silver had upset entirely the budgetary equilibrium, and the Government of India suggested to the Secretary of State in March, 1879, that no action should be taken on the taxation proposals. The extension of taxation was likely to yield only about £200,000, a sum which was quite inadequate for meeting the deficit.[2] In July, 1879, the Secretary of State conveyed his sanction to the abandonment of this plan.

The Government of India thereupon formulated another and a more comprehensive proposal for the taxation of all the classes which had hitherto escaped direct taxation, including the landlords, and invited the opinion of the Provincial Governments on these proposals.[3] In inviting an expression of opinion the Government of India pointed out that, under the existing licence taxes, large numbers of persons were being taxed with comparatively little financial advantage to the State. The Provincial Governments were practically unanimous so far as the proposal to tax the professional classes and the officials was concerned. But the Governments differed among themselves when it came to the question of taxing the income from land.

[1] *Vide* letter of the 21st November, 1878—*Correspondence, Debates in the Legislative Council and Minutes relating to Direct Taxation* (1882), Vol. II.
[2] *Vide* letter from G. of I. dated the 13th March, 1879.
[3] *Vide* circular letter from G. of I., 19th August, 1879.

The proposal to include this category of income in the tax system was therefore dropped.

Attempt renewed in 1879.

On the 14th November, 1879, the Government of India introduced in the Indian Legislative Council a bill on these lines to amend and consolidate all the Licence Acts. The bill proposed to fix the minimum taxable income throughout British India at Rs.250 a year, and to extend the tax to the officials and other salaried employments. It was proposed that all salaries in excess of Rs.1,200 a year should be taxed at a uniform rate of 1½ per cent. It was further proposed to extend the tax to the professions throughout the country, as they were already taxed in Calcutta. The classification was so arranged as to fall as nearly as possible at the rate of 1½ per cent.[1] The preamble that appeared in the existing Licence Acts that the revenue was needed to defray public expenditure incurred for famines was dropped. The measure as thus drafted sought to put the tax on a more equitable basis than it had been in the past. At the same time it is difficult to find any justification for the new anomalies the bill sought to create. Mr. Fawcett rightly pointed out that it was anomalous to impose taxation on a petty trader whose income was Rs.250 a year, and at the same time to exempt from taxation persons in receipt of salaries several times as large.[2]

When the bill embodying these provisions came to be circulated, some of the Provincial Governments objected to the very features which they had themselves suggested, while others condemned the measure on the ground that it did not go far enough. The Government of Bengal thought the taxation of officials to be "a concession to a really unmeaning popular cry," while the Governments of Bombay and Madras failed to see any reason why the landholders living on rents and the fundholders should not be taxed. The Provincial licence taxes (with the exception of the Bengal tax) were all assessed for the calendar

[1] Sir John Strachey's speech—*Indian Legislative Council*, 14th November, 1879.

[2] Fawcett: *Indian Finance*, p. 182.

year. The Government of India had therefore intended to pass the amending bill before the end of the year 1879, so that the Act could be put into operation from the beginning of the calendar year 1880. It became evident, however, during the closing month of the year that it would not be possible to expedite the passing of the measure, as the bill was referred to the Select Committee as late as the 24th December, 1879.

But what surprised most people was that the bill which was thus referred to the Select Committee on the 24th December was not the bill which had been originally introduced on the 14th November; for the Government of India had made several alterations of a fundamental character in its provisions. In the first place the original idea of passing a measure applicable throughout British India was dropped. The Government now decided to settle the main lines of policy, leaving the details to be determined by the various Provincial Legislatures. Circumstances differ so widely in various parts of India that it was felt that it would be unwise to lay down one uniform measure. In the second place it was proposed that the taxable minimum should be raised to Rs.500 a year, and the loss of revenue resulting from this step made good by the increased taxation of the professions and trades. By raising the taxation to Rs.800 a year, the maximum fee permissible under the Madras enactment, the Government estimated that they would obtain an additional sum of £240,000 a year.

Some of the members of the Legislative Council, including Messrs. Paul, Pitt-Kennedy and Morgan, protested against the unconstitutional step taken by the Government, and argued that, in view of the changes introduced in the draft bill subsequent to its original publication, it should have been withdrawn and a new one introduced.[1] These objections were overruled and the Government decided to push on with the new measure. But even in this modified form the bill was not destined to pass. As there was a slight improvement in the financial situation, the Government of India proposed to the Secretary of State on the 5th February,

[1] Proceedings of the *Indian Legislative Council*, 24th December, 1879.

1880, that the question should be reconsidered in the light of the new situation. On the 16th February, 1880, the Government of India again informed the Secretary of State that in view of the improved prospects of finance, they "could not justify the extension of taxation to official and professional classes." The only change which they now proposed in the existing licence taxes was the raising of the exemption limit to Rs.500, leaving the other features intact. The Secretary of State at first hesitated to acquiesce in this policy, but, it appears, had to yield on pressure from the Government of India. On the 18th February, 1880, the Viceroy (Lord Lytton) sent a telegram to the Secretary of State in the following terms: "Whatever view be taken of policy, it is impossible now to carry the measure. Neither I nor any member of the Executive Government can support it, and the Legislative Council would probably not accept it." [1] Six days after the despatch of this telegram, Sir John Strachey moved in the Legislative Council that the resolution which the Council had passed on the 24th December, 1879, referring the licence tax amendment bill to a Select Committee be cancelled. With the cancellation of the original resolution ended the second attempt on the part of the authorities to remove what was undoubtedly a gross anomaly in the tax system of the land.

In justifying this course of action, Sir John Strachey observed:

> "Admitting as we must do in the present state of the finances that we do not absolutely require the £240,000 which the contemplated taxation of these classes would yield, is it now desirable to impose it merely for the purpose of our making our system of taxation more theoretically equal and removing to some extent the reproach which undoubtedly is true that certain classes do not at present bear the full share of public burdens?"

Act VI of 1880.

He then introduced a new measure which became law at the next sitting of the Legislative Council [2] and was known as the Licence Acts Amendment Act (VI of 1880).

[1] *Correspondence, Debates in the Legislative Council and Minutes relating to Direct Taxation in British India* (1882), Vol. II.

[2] Proceedings of the *Indian Legislative Council*, 2nd March, 1880.

This Act was divided into three parts: one relating to the North-Western Provinces, Oudh and the Punjab, another to Bombay, and the third to Madras. The taxable minimum for each of these areas was fixed at Rs.500 per annum. The case of Bengal was left out to be dealt with separately by the Bengal Legislative Council. Besides raising the taxable minimum, the Act introduced very little changes. In Bengal the tax had always been collected for the financial year, but in the other Provinces the practice was to collect it for the calendar year. The amending Act provided for the adoption of the Bengal system in the other Provinces.[1] A doubt having arisen in some Provinces as to whether tea companies selling their own produce were liable to pay the licence tax,[2] the question was settled in the new Act by providing for their exemption. The Act further afforded relief to those traders whose activities covered more than one Province. Such traders were often called upon to pay licence tax in each one of those Provinces. Section 19 of the amending Act provided that they should not be called upon to pay the tax in more than one Province.

The Madras Government followed up this measure with another Act passed in the local Legislative Council, which reduced the maximum fee payable from Rs.800 to Rs.500.[3] Act II of 1880 passed by the Bengal Legislative Council amended the Act of 1878 on lines similar to those laid down for other Provinces. The taxable minimum was raised to Rs.500. The use of the municipal agency in the assessment and collection of the tax was abandoned, as the municipalities had not taken kindly to this task. With the exemption of smaller incomes, it was now thought unnecessary to retain the separate schedules applicable to the metropolis and the country districts. Henceforth there was to be one schedule of taxes applicable throughout Bengal. The provision of the old

Bengal Act II of 1880.

[1] Sections 6, 10 and 15 of Act VI of 1880.

[2] Tea and other companies paying the Road Cess in Bengal were declared exempt from the licence tax under executive orders.

[3] Madras Act III of 1880—*An Act to amend the Schedule annexed to "The Madras Licence Act, 1878," as amended by Act VI of* 1880.

Act under which persons carrying on business in more than one district in Bengal had to take up several licences was repealed, and sections 6 and 9 of the new Act provided that one licence would cover all the districts. During 1880–1 760 persons who had been taxed in the previous year in more than one district were exempted from double taxation.[1]

Modification in the *Pandhari* Tax, 1880.

As the Government of India's amending Act did not apply to the Central Provinces, it was necessary for the Government to deal with the case of this Province separately. The Government of India accordingly addressed a letter to the Central Provinces Government inquiring whether exemptions similar to those made in other Provinces should be made in respect of the *Pandhari* tax.[2] The Chief Commissioner felt that the case of the Central Provinces stood on a different footing altogether, as the *Pandhari* was an old and familiar impost which had always been paid by the people, and that there was no reason why the system prevalent in the Central Provinces should be assimilated to that existing in other Provinces. The Chief Commissioner observed : " As *Pandhari* was paid in these Provinces when no licence taxes existed elsewhere, there can be no hardship in classes continuing to pay who have always paid and who would presumably have continued to pay, if no licence tax had been introduced in other Provinces." [3] The Government of India agreed with this view, and, as a result of further correspondence, a minimum taxable limit of Rs.250 was fixed. By thus raising the taxable limit from Rs.150 to Rs.250 as many as 26,508 persons were relieved out of an aggregate of 52,905 persons.

An Appraisal of the Acts of 1880.

Under the different Licence Acts prevalent in various parts of India in 1878 about 2,000,000 persons were assessed to the tax, paying roughly a sum of £900,000 (90 lakhs of rupees). The amendments introduced had the effect of relieving as many as

[1] *Vide Report on the Administration of the Licence Tax, Bengal,* 1880–1.
[2] *Vide* letter of the 7th June, 1880, to the Chief Commissioner, C.P.
[3] *Vide* letter from C.P., dated the 23rd June, 1880.

1,600,000 persons, while the total loss of revenue amounted to £360,000. The raising of the taxable minimum relieved the poorer section of the tax-payers, and the contemporary official reports point out that the feeling against the tax subsided to a great extent. The Lieutenant-Governor of Bengal observed in 1883: "No one has yet discovered a tax which a conscious assessee would take pleasure in paying, and in India all direct taxation must involve a risk of extortion and oppression being practised. But while reluctance to pay will naturally remain, there is every reason to hope that the other elements of unpopularity will gradually disappear." [1] The Collector of Bogra, in reviewing the administration of the tax in his district during 1883–4, remarked that the tax was not popular, but there was no open discontent. In the North-Western Provinces also the unpopularity to a large extent died away. The Secretary to the Government of the North-Western Provinces observed in 1881: "The exemption of persons with incomes below Rs.500 from assessment has removed a great burden from a large number of poor people and has very greatly reduced the work of district officers." [2] In Bombay also, as a result of the new Act, 86 per cent. of the assessees who were taxed before were relieved, and the official report points out with satisfaction that "there is not now much open complaint." [3]

[1] *Vide Report on the Administration of the Licence Tax in Bengal*, 1882–3 —Resolution of the Government of Bengal dated the 26th November, 1883.

[2] *Vide* letter of the 17th October, 1881, from Secretary, Government of the N.W.P., to Secretary, Board of Revenue, N.W.P.—*Licence Tax Administration Report, N.W.P.*, 1880–1.

[3] *Vide Licence Tax Returns of the Bombay Presidency, including Sind and Aden*, 1878 *to* 1881–2, p. 8.

CHAPTER VIII

THE INCOME TAX OF 1886

IN 1886 the licence tax was converted into an income tax, which brought under contribution all incomes other than those derived from agriculture. This increase of taxation was needed in view of the financial stringency which confronted the Government at the time.

Events Leading to the Imposition of an Income Tax in 1886.

In 1885 occurred the Pȧnjdeh incident, and it became necessary for the Government to reconsider the military situation. The advance of Russia into close proximity to the British frontier necessitated the strengthening of the frontier defence works and an extension of the strategic works. The annexation of Upper Burma also entailed heavy outlay until such time as the Province was in a position to pay its way. The Government were further embarrassed by the fall in the gold value of silver. It was apprehended that the exchange value of the rupee would fall from 1*s*. 7*d*. to 1*s*. 6*d*., and this one item alone was likely to entail an additional expenditure of 1 crore of rupees. It is doubtful if all these causes would have made the financial situation so desperate, but for the line of action which the Government had adopted in 1882 and 1883. In March, 1882, the salt duty had been reduced to Rs.2 a *maund* (except in the trans-Indus districts of the Punjab and in Burma) at a cost of £1,400,000. In 1878 and 1879 the import duty on coarse cotton cloth had been removed, and in 1882 the remaining cotton duties were abolished at a gross cost of £1,219,000. During 1882–3 the *Patwari* cess levied for the maintenance of the village revenue officers in the North-Western Provinces was also abolished. The amount sacrificed was

£316,000, and the Government undertook to pay the sum out of the general revenues. On top of these came the reduction of duty on Malwa opium.

These heavy reductions, particularly at a time when the Government were confronted with a serious exchange crisis, were perhaps too hasty. But, for the time being, the surplus that followed in spite of the abolition of these taxes showed that the Government had been right. The year 1882–3 showed a surplus of £700,000; [1] the year following showed a still larger surplus of £1,387,496. In 1884–5 and 1885–6 the finances were practically in equilibrium. But the situation changed in 1886–7. As Sir Auckland Colvin [2] pointed out: "With the present year, our brief spell of happiness has come to an end; the fat kine have passed on; the lean kine are come in. Three uninterrupted years of prosperity is a godsend in the annals of any nation; in our Indian annals it is extraordinarily rare good fortune."

It became necessary, therefore, to consider ways and means. Economy was not possible immediately to any large extent, as the financial contracts with the Provinces stood in the way. Indirect taxation it had been the avowed policy of the Government of India for some years past to avoid. The duty on salt could not be raised without adding to the burdens of the poorer classes. As regards customs duties, it was the prevailing idea in Great Britain that the duties on cotton textiles were protective in their nature, and as such could not be reintroduced without the Government laying themselves open to the charge of protecting Indian industries at the expense of Lancashire. Recourse was therefore had to direct taxation in the shape of an income tax.

[1] Proceedings of the *Indian Legislative Council*, 4th January, 1886.

[2] Sir Auckland Colvin (1838–1909) was appointed Finance Member in August, 1883. Colvin's countrymen in India disliked the income tax which financial necessity forced him to impose. Kipling has immortalized him in his "Departmental Ditties" by the *Rupaiyat of Omar Kal'vin*, "which represents the Finance Member as plying the begging bowl among his European countrymen." Colvin also served in Egypt. He rendered valuable service as English controller of Egyptian finance and financial adviser to the Khedive.

It was admitted on all hands that the licence tax as it stood, even after the modification introduced in 1880, was unfair in its operation. The obvious remedy lay in extending the tax to those who had hitherto escaped paying it. Indeed, it is possible to maintain that the policy which the Government were forced to adopt in 1886 in the matter of taxation was the direct and the inevitable outcome of the remissions granted on a liberal scale during 1882–3. As the tax system stood in 1886, the upper-middle and the upper classes enjoyed the greatest immunity from taxation. The Governor-General (Lord Dufferin), speaking in the Legislative Council, pointed out this defect of the tax system in a forceful speech. He remarked :

> "I look around this very table and what do I see ? That there is not one of us into whose pocket Sir Auckland Colvin is able to get so much as his little finger. For instance, take my friend, Mr. Mandlik, a most eminent and distinguished member of the legal profession. He will admit, I am sure, that his qualifications to rank as a tax-payer are of the most microscopic proportions. . . . I might make the same appeal to most of our other colleagues, and, what is equally sad, I am forced to make an identical confession in regard to myself and to the members of the Government. There is not one of us who pays any really serious sum from his income into the Imperial exchequer." [1]

The imposition of an income tax, while it enabled the Government to remove an undesirable feature of the tax-system, furnished them at the same time with funds which they sorely needed.

The Act for "imposing a tax on income derived from sources other than agriculture" [2] fixed the taxable minimum at Rs.500 a year. The rate of the tax was 4 pies in the rupee (2 per cent. approximately), except in the case of incomes above Rs.2,000 a year, which were taxable at 5 pies in the rupee. The bill as finally passed differed in important respects from the proposals which the Govern-

The Income Tax Bill of 1886—Changes made by the Select Committee.

[1] Proceedings of the *Indian Legislative Council*, 4th January, 1886.
[2] Act II of 1886.

ment originally made. In the draft bill a special privilege was given to Government servants drawing salaries below Rs.100 a month, who were declared exempt from taxation. As this favoured treatment was likely to lead to jealousy and recriminations between different sections of the community, the provision was dropped in the Select Committee, with the result that all classes of income were placed on the same footing as regards taxable capacity. The Select Committee introduced certain other amendments with a view to make the tax more acceptable to the people. Thus an abatement was allowed in respect of life insurance premiums to the extent of one-sixth of income. The original bill contained no provision for appeal to the higher authorities. This was modified by section 27, under which an assessee could appeal to the Commissioner of a Division as a matter of right, if the original assessment amounted to Rs.250 or upwards. In all other cases the Commissioner could at his discretion call for the records of the case on the petition of the person aggrieved by the order of the Collector. Two other changes introduced were designed to afford some relief to the commercial community. The original proposal was to require all companies or associations of individuals or private employers to collect the income tax on behalf of the Government from persons in their employment. As it was felt that the operation of this clause would have caused vexation and annoyance to the mercantile community, the clause was made optional, and the Collector was empowered to arrange on suitable terms for the collection of the tax.[1] The Select Committee finally exempted the profits of foreign shipping companies from taxation,[2] as it was found difficult to estimate the profits of such companies over the period during which they operated in Indian waters.

The Provisions of Act II of 1886.

The Act divided all incomes into four different classes. These were taxable under four different parts of the second schedule attached to the Act. The classes of income are set out below:

[1] Section 9 (2), Act II of 1886.
[2] Section 5 (1) (*d*), Act II of 1886.

PART I.—Salaries, annuities and pensions taxable at the rate of 5 pies in the rupee if the income amounted to Rs.2,000 a year or more. Incomes between Rs.500–1,999 were taxable at the rate of 4 pies in the rupee.

PART II.—Profits of companies were taxable at a uniform rate of 5 pies in the rupee.

PART III.—Interest on securities was taxable at the rate of 5 pies in the rupee, if the income from all sources amounted to Rs.2,000 a year or more, and at 4 pies in the rupee if the income was between Rs.500–1,999.

PART IV.—Other sources of income not included above were chargeable at the following rates—

If the annual income was assessed at not less than Rs.500, but at less than Rs.750, Rs.10

750	do.	1,000,	15
1,000	do.	1,250,	20
1,250	do.	1,500,	28
1,500	do.	1,750,	35
1,750	do.	2,000,	42

On all incomes of Rs.2,000 or more the tax payable was 5 pies in the rupee.

Agricultural income and income derived from property solely employed for religious or public charitable purposes were exempted from taxation. The salary of any officer, warrant officer, non-commissioned officer or private of Her Majesty's forces holding a position solely reserved for " military persons " not exceeding Rs.500 a month was exempted.[1] The Governor-General in Council was also empowered to exempt from taxation the whole or any part of the income of any class or tribe, or of any persons residing in any specified area.[2] In exercise of these powers the Governor-General in Council exempted all persons other than Government servants residing in the Chittagong Hill Tracts.[3] Similarly the Maharaja of Cooch-Behar having made a representation to the Government of India regarding the assessment of the tax on himself and his officers during their stay in Simla, they were exempted, as the revenues were derived from the Native State of Cooch-Behar.[4] A few months after the

[1] Section 5, Act II of 1886. [2] *Vide* section 6, Act II of 1886.
[3] *Vide I.T. Manual*, 1907, p. 13.
[4] G. of I. 4904 J, 15th December, 1888, to the Government of the Punjab—*Income Tax Manual* (1907).

passing of the Act of 1886 the Government of India exempted from taxation the profits derived by municipalities from commercial undertakings.[1]

The Act was passed without any time limit, and an amendment moved in the Council to limit the duration of the measure to one year was negatived. The Finance Member refused to give any pledge regarding the duration of the tax, though repeatedly pressed by many members of the Legislative Council to do so. " Prudence," he remarked, " is to a Financial Member what modesty is to a woman, and if he once throws it aside he must expect to descend to that fallen class from whom nothing more may be hoped for." Apart from any question of prudence, the past history of income tax administration in India, particularly during 1869–73, suggested that no step was more calculated to make the income tax unpopular with the Indian people than annual changes which they could not understand. In this connection the opinion of one official member of the Council may be quoted with advantage. He remarked: " I can imagine few conditions more economically and commercially prejudicial, if not more politically dangerous, than that all India should come to be thrown annually, from December to March, into a state of doubt and speculation as to what their fiscal burdens for the coming year would be." [2]

Tax of 1886 Compared with Previous Taxes.

It was not expected that a comprehensive measure which brought under taxation the various sources of income, with the one exception of agriculture, would be allowed to pass through the Legislative Council without some criticism. In fact, the framers of the measure were prepared for such attacks. They knew full well that the old and rusty weapons of attack, " the arquebuss of 1860 and the muzzle-loader of a later day will be furbished up and brought out with the last weapon of the moment." The old objections against the income tax as being unsuited to an Oriental people, as being extortionate and oppressive, were again paraded round

[1] Notification 434 of the 27th April, 1886.
[2] Mr. Hope's speech—*Indian Legislative Council*, 11th January, 1886.

the Council table. But they did not produce much effect. For, with the lapse of time, they had lost much of their force and vitality. The only novel objection which the critics could muster was that the tax would prejudicially affect the European community already hard hit by the effects of a falling exchange. This objection, however, was not seriously advanced and several non-official representatives of the European commercial community expressed their readiness to bear their fair share of the burdens at a time when the State was confronted with a crisis.

The Act thus passed, though called an income tax, was, like its predecessor, a combination of licence tax and income tax. Thus, so far as salaries, income from securities, and the profits of companies were concerned, the measure operated as an income tax. On the other hand, with regard to other sources of income between Rs.500–1,999 taxable under Part IV, it was purely a licence tax. It was the duty of the Collector under section 16 (1) of the Act to prepare a list each year of persons chargeable under Part IV, whose annual income did not exceed Rs.2,000 a year. Traders, moneylenders, professional men with incomes not exceeding Rs.2,000, were taxed by means of licences, while men in receipt of Rs.2,000 or more, as well as all salaried servants, fundholders and shareholders of companies, were taxed exactly in proportion to their income. The characteristic feature of the new tax is thus described in the words of the Governor-General:

> "The licence tax is a one-storied house, and on the top of it we are putting a second storey, but the order of architecture in both will be the same; and as the foundations of the one have stood the test of time and of popular criticism, so I trust will the walls of the other possess the same solid characteristics."

In trying to assess the smaller incomes by means of a licence tax, inquisitorial procedure was avoided to a large extent. The rates of taxation prescribed under the new Act were not materially different from those prevailing under the Licence Acts, while the taxable minimum was also main-

tained at the old level. The tax may therefore be rightly described as "one built on the foundations laid nine years ago."[1]

The main characteristic which distinguished the income tax of 1886 from the previous income taxes is the exemption of agricultural income from taxation. Under Act XXXII of 1860, as well as under the various Income Tax Acts passed between 1869–73, incomes from agriculture were subjected to taxation in common with other sources, and, for the first time in the history of Indian finance, agriculture came to be exempted in 1886. Any rent or revenue derived from land used for agricultural purposes either assessed to land revenue or subject to a local rate, or any income derived from the pursuit of agriculture, was declared immune from taxation.[2] The explanation of this exemption is to be found in the continuation of the cesses on land which were levied in the early 'eighties on the agriculturists. As the main object of the Act of 1886 was to remove the anomaly resulting from the exemption of certain categories of income, there was no occasion for disturbing an arrangement under which the agriculturists continued to contribute their quota of taxes, though small in amount, in the shape of cesses on land of varying descriptions imposed in the different Provinces of India. Whether the continuation of this exemption is justified at the present day, in view of the changes in the character of the cesses that have since taken place, is a different problem and is reserved for subsequent discussion. There is, however, one observation to be made in this connection. No provision of the Income Tax Act has been a more prolific source of litigation between the Crown on the one side and income tax assessees on the other than section 5 (1) (*a*), (*b*) of Act II of 1886 or the sections which have replaced it in the subsequent enactments. Questions have arisen from time to time whether the profits of sugar factories, of tea gardens, of timber companies, constitute agricultural income or not. Similar questions have arisen

[1] *Vide* Sir Auckland Colvin's speech, *Indian Legislative Council*, 4th January, 1886.

[2] Section 5 (1) (*a*), (*b*), Act II of 1886.

with regard to premia paid to a landholder [1] for the recognition of a transfer of holding from one tenant to another, or with regard to the royalty on coal received by a landlord. These questions have given rise to endless controversies, and have been the occasion for the display of legal learning and acumen by distinguished lawyers on both sides. It has been decided, for instance, that income which is exempt at the source might be so employed as to produce taxable income. Rent or revenue under section 5 (1) (*b*) of the Act II of 1886 might be used for money-lending business, and income derived from such business is not exempt simply because the capital is derived from agriculture.[2] *Jalkar*, forest income and income from *bastu* lands rented to non-agriculturists have also been declared liable.[3] But the *salami* paid to a *Zemindar* for the creation of *Patni* or *Darpatni* or other tenures has been declared immune from taxation, as such payments should be taken as the price paid to the proprietor for a portion of his rights, or as an advance payment of rent. The decisions on these and similar other questions have not always been consistent with one another. It is difficult for a layman to understand why the royalty on coal received by a landlord should be declared taxable, while the *salami* paid to him for granting settlement of mineral-bearing lands should enjoy an immunity.[4]

Application to Lower Burma—Capitation Tax.

The Act of 1886 applied to the whole of British India with the exception of Lower Burma, to which it was subsequently extended with effect from the 1st April, 1888. Though nominally extended to the whole Province, it was applied at first only to twenty-seven towns. The operation of the Act was extended from time to time, till at last in 1905 it was made applicable throughout Lower Burma. In this Province the situation was complicated due to the existence from very early times of a capitation tax, which used to be levied under the native kings of Burma. When Lower Burma was annexed by the

[1] *Nawabzadi Meher Bano Khanum and others vs. Commissioner of Income Tax, Bengal.*

[2] *Income Tax Manual*, 1907, p. 6. [3] *Income Tax Manual* (1907).

[4] *Vide Report of the Central Board of Revenue on Income Tax*, 1924–5, p. 8.

British, they found that under the old regime this tax was payable in kind by the wandering tribes such as the *Karens* and *Salons*. The British Government fixed the capitation tax in money and extended it to all the inhabitants. The imposition of this tax was regularized by the (Lower) Burma Land and Revenue Act, 1876 (II of 1876), which fixed the rate at Rs.5 a year for married men and at Rs.2½ a year payable by bachelors. It was virtually a poll tax, as it was payable by all males between the ages of 18 and 60. Persons incapacitated from earning their livelihood, Government servants, honorary magistrates, village headmen, recognized schoolmasters, priests, teachers of religion, the *patamagyaw*,[1] the village crier and a few other persons have been exempted from the tax from time to time. There were certain districts in Lower Burma, e.g., Rangoon, Bassein, Prome, Akyab, Henzada, etc., in which a land rate was imposed in lieu of the capitation tax.[2] When income tax came to be imposed in 1888, all income tax assessees were exempted from the capitation tax or the land rate in lieu thereof.[3]

Application to Upper Burma.—*Thathameda*.

As regards Upper Burma, although not in force there formally, the tax was imposed on Government servants and pensioners from the very beginning. Even when it was made applicable to the whole of Upper Burma in 1896, it was enforced only in the town of Mandalay. The explanation of this reluctance to enforce the income tax is to be found in the existence of an indigenous levy known as the *Thathameda*. Like the capitation tax in Lower Burma, it dates from the regime of the kings of Burma.[4] In the olden times practically the only tax levied was the *Thathameda*, for the land revenue was payable only on State lands and not on other lands. When under the British Government land revenue was extended to all lands, *Thathameda* was converted into a

[1] Literally means " the celebrated first " in the Patamabyan examination. This was an examination in Pali and canonical lore dating from olden times and was continued by the British.

[2] Sections 34–36, the (Lower) *Burma Land and Revenue Act*, 1876.

[3] Section 48, Act II of 1886.

[4] *Vide* Resolution, *Burma I.T. Administration Report*, 1897–8.

tax on all incomes other than those derived from agriculture.[1] Under the Burmese kings the rate of this tax was fixed at Rs.10 per household in a village. Poorer villages paid less than Rs.10. The lump contribution for the village was first fixed by multiplying the village rate by the number of households in the village. The total amount thus arrived at was distributed amongst the households by *thamadis* (assessors). The household rate therefore was different from the village rate. Thus while the village rate was Rs.10, the household rate might be more or less than this according to the circumstances of the householders.

Under British rule the main features of the *Thathameda* have been kept intact. Its imposition is now regulated by the Upper Burma Land Revenue Regulation, 1889 (Act III of 1889). The Settlement Officers now fix the normal rate for the village. The proportion of non-agricultural to agricultural income is usually taken as representing the fraction of Rs.10 which should be the *Thathameda* rate for the village.[2] After the normal rate for the village has been determined, the lump sum for the village is obtained by multiplying the rate with the number of revenue-paying householders, including the households residing in boats.[3] The *thugyi*, or the headman, then proceeds to distribute this lump sum with the aid of *thamadis*.

As the *Thathameda* had never been in existence in Mandalay income tax was imposed on the residents of this town. From 1909 the income tax came to be levied also on the European employees of industrial and commercial companies. This innovation was due to the difficulty of assessing the *Thathameda* on the Europeans in Upper Burma on account of constant changes in the residence of these officers. The income tax levied on these officers was collected at the head offices of companies.[4] In 1924 the income tax was imposed for the first time throughout Upper Burma. A

[1] *Vide* evidence of Mr. Smyth, Commissioner, N.W. border Division, Burma, *Report of the Indian Taxation Inquiry Committee*, Vol. VI.

[2] *Report of the Land Revenue Committee, Burma*, 1922, p. 128.

[3] *Vide* Rule 13 (1) *U.B. Land Revenue Regulation*, 1889.

[4] *Report on the Operation of the Income Tax in Burma*, triennium 1908–9–1910–11.

rebate to the extent of the *Thathameda* is now given in the case of assessees who pay both the income tax and the *Thathameda*. It has been decided that by 1932–3 the capitation tax and the *Thathameda* should cease to be sources of Provincial revenue, the proceeds being utilized for local purposes only. In 1927 the Government of Burma resolved to credit the proceeds of these two taxes (including land rate in lieu of capitation tax) to a special fund ear-marked to meet the needs of local bodies, and to debit to this fund all contributions from Provincial to local funds.

The Future of Capitation Tax and *Thathameda*.

In 1926–7 these two taxes yielded a sum of Rs.9,650,000, while the contribution from the Provincial exchequer to the local bodies amounted to Rs.5,950,000 only. This contribution is to be increased from year to year till 1932–3, when it is expected that the whole of the receipts from the capitation tax and the *Thathameda* will be absorbed by the local bodies.[1]

In the Central Provinces the situation was analogous to that existing in Lower Burma, owing to the existence of the *Pandhari* tax. Persons paying income tax were exempted from the *Pandhari*, the last tax being confined to lower grades of income.[2]

It was too much to expect of human nature that the income tax of 1886 should be favourably regarded by the people. But there was no widespread manifestation of discontent against it. Indeed, it was noticed that to those who had been assessed under the licence tax, the widening in the scope of the tax so as to include the salaried occupations and the professional classes afforded some consolation. The Finance Member pointed out in 1888, on a review of the reports of the Provincial Governments for the year 1886–7, that considerable success had been attained in the endeavours made to render the tax as palatable as possible.[3] The Lieutenant-Governor of Bengal, in reviewing the work of income-tax administration during 1886–7, remarked: " The unpopularity of a direct tax may be greatly enhanced

[1] *Report of the Capitation and Thathameda Taxes Inquiry Committee*, 1926–7; also the Resolution of the Government of Burma, dated the 29th June, 1927, on this Report.

[2] Section 48, Act II of 1886.

[3] *Financial Statement*, 1888–9.

by injudicious administration, but the Lieutenant-Governor is glad to be able to record his belief that in the present year the dislike to the tax has not been seriously aggravated by errors in its working." It is, however, notworthy that the administration of the tax during these days was not always of a character calculated to rally public opinion in favour of the Government. During 1890–1, for instance, a distress warrant was issued on the firm of Messrs. Finlay Muir & Co. for a sum of 1 pie. This firm was called upon to remit this amount, being the balance of income tax due to the Government. A delay having occurred in payment, a distress warrant followed. In a statement of accounts sent with the warrant the balance was stated to be 2 pies. A penalty of 2 pies and the charges amounting to 4 annas brought the total to the sum of 4 annas and 4 pies. For the recovery of this sum, the Collector distrained one wooden table and one chair.[1] The whole incident was trivial in the extreme, but it shows more eloquently than an array of figures regarding appeals and assessments could have done, the spirit in which the tax was at times administered during those early days.

The Administration of the Income Tax.

This was, however, an isolated instance, and too much should not be made of it. The opposition to the tax of 1886 was not very intense and was confined to a small section of the people. Thus the European tea-planters and indigo-planters in Bengal and Behar at first objected to the tax, and against some of them extreme measures had to be taken to compel payment. The Deputy-Commissioner of Jalpaiguri (Bengal) noted, in the course of the official review of the income-tax work during 1893–4, that the planters with very few exceptions gave the authorities endless trouble, and by their recusancy threw a considerable amount of work upon the department.[2] In the same year the Commissioner of Patna said that the tax was unpopular with the indigo-planters, who were hard hit by the falling exchange and the reimposition of customs duties on liquors

[1] *Vide Report of the Bengal Chamber of Commerce*, 1891–2, Vol. I, p. 58 *et seq.*
[2] *Vide Income Tax Administration Report, Bengal*, 1893–4.

and stores. A section of the Indian people also, at times, took recourse to amusing devices in some parts of the country in order to obtain exemption from the tax. A device which was sometimes resorted to was the use in public, particularly before the District Officers, of old and tattered garments so as to be able to plead poverty. Mr. Finlay, the Collector of Agra in 1886–7, noted on one occasion a particularly bad coat full of rents, holes and ink-marks. This coat was used on the same day by more than a dozen objectors. Unfortunately, one of the assessees who was wearing it drew the attention of the Collector to its tattered condition and pleaded that he was too poor to pay income tax. On the Collector replying that he recognized the coat very well indeed, it was set aside for the rest of the day. A rich moneylender, who had been assessed to income tax, desirous of proclaiming his poverty, filed an application for *takavi* advance the day before his income-tax objection was heard.[1] It is, however, significant that with regard to assessments under Part IV under which objections were chiefly raised, the percentage of objectors to the original assessees was not very numerous during 1886–7. Eleven per cent. of the original assessees were on objection absolved from taxation, while the amount of assessment was on the whole reduced by 19 per cent.[2] These figures compare very favourably with those relating to the tax of 1860. In course of time people became reconciled to the tax as a necessary evil, and the little opposition that the authorities had to contend with at the outset soon melted away.

The gross collections of the tax during the first year of operation was Rs.13,547,350. The percentages of collections distributed under the four parts of the second schedule to the Act of 1886 were as follows:

			Percentage of the whole.
Part	I.	Salaries	30·4
,,	II.	Companies	5·4
,,	III.	Interest	5·3
,,	IV.	Other sources	58·9

[1] *Income Tax Administration Report, N.W.P.*, 1886–7.
[2] See *Financial Statement*, 1888–9.

The net collection, i.e., gross collection with a deduction for refunds and cost of collection, was Rs.12,775,110. Of the gross collections the Province of Bengal contributed over Rs.3,338,000, while Bombay's share was a little over Rs.2,570,000.[1] It will be observed that these two Provinces taken together accounted for nearly half the total receipts.

The Yield of the Tax.

The net yield of the income tax during 1886–7 is compared with the collections from the Provincial licence taxes during 1885–6 in the table below:

	Licence Tax Collections in 1885–6.	Income Tax Collections in 1886–7.	Percentage of Total Collections.	Increase of Income Tax over Licence Tax.
	Rs.	Rs.		Rs.
India	1,060	1,224,060	9½	1,223,000
Central Provinces .	226,560	398,360	3	171,800
Burma	—	160	—	160
Assam	50	199,050	1½	199,000
Bengal	1,391,670	3,336,270	26	1,944,600
N.W.P. and Oudh .	1,129,540	2,136,390	17	1,006,850
Punjab	357,470	1,056,520	8	699,050
Madras	418,510	1,386,740	11	968,230
Bombay . . .	1,203,140	3,037,560	24	1,834,420
Total . .	Rs.4,728,000	Rs.12,775,110	100	Rs.8,047,110

An analysis of the distribution of incomes as they stood in 1886 revealed the fact that 90 per cent. of the assessees had incomes under Rs.2,000, contributing 50 lakhs of rupees only or 38 per cent. of the total collections. Persons in receipt of incomes between Rs.500–750 numbered 51 per cent. of the whole body of tax-payers, but they contributed only 14 per cent. of the revenue. Those earning between Rs.750–1,000 numbered 13 per cent., and contributed 6 per cent. of the total yield.[2]

Changes made in 1902 and 1903.

The main features of the income tax of 1886 remained unaltered till after the outbreak of the great European War. The slight changes which were made in the intervening years were directed

[1] These figures exclude the tax on salaries of Government servants.

[2] In these calculations the interest on securities was omitted from consideration, as the distribution of this income by classes was not shown—*vide Financial Statement*, 1888–9.

towards giving relief to the poorer class of tax-payers. In 1902 the Government of India found themselves the fortunate possessors of a considerable surplus, arising from a steady improvement in the receipts from all the major sources of revenue. This surplus was not an isolated or a casual one, but had been preceded by several good years, which denoted a period of continued prosperity. The surplus of revenue over expenditure from 1899–1900 to 1902–3 is shown below:

Year.	Surplus.
1899–1900	£2,774,623 (actuals).
1900–1	£1,670,204 „
1901–2	£4,950,243 „
1902–3	£2,738,500 (Revised estimate).

The Government of India therefore decided to distribute this surplus in such a manner as to "directly reach the pockets of those classes most in need of assistance." Arrears of land revenue amounting to Rs.19,823,000 (£1,321,500) were remitted. Special money grants were made for irrigation, education, sanitation, and minor public works. The Government also decided upon the abolition of the *Pandhari* tax in the Central Provinces at a cost of Rs.70,000. The *Pandhari*, as we have already seen, was virtually a tax on incomes below Rs.500 a year. It was a source of considerable irritation to the poorer people, and as early as 1872 a petition had been presented to the Governor-General pointing out the hardships and iniquities of a tax which was collected by "attachment of cooking utensils, by instrumentality of subordinate native officers such as *Tahshildars* and police *darogas*." [1] It was a matter for congratulation that the Government should have been able to grant relief to these humble tax-payers.

Close upon this relief granted to the Central Provinces, the Government of India again came forward in 1903 to grant remissions to poorer income-tax assessees throughout British India. In that year the taxable minimum, which had been fixed at Rs.500 a year in 1886, was raised to Rs.1,000.

[1] For the opinions expressed by the District Officers on the *Pandhari* tax, see *Reports on Taxation in British India*, 1872 (1873), pp. 370–426.

Here again this liberal policy was the outcome of surplus amounting to £948,700 anticipated during 1903–4. It was therefore proposed to utilize this surplus in the remission of taxation as far as practicable and, for the first time since 1882, the Government felt themselves justified in affording substantial relief to the poorer class of tax-payers. The form which this relief took was the reduction of duty on salt throughout British India (except Burma), and the exemption of all incomes below Rs.1,000 a year from the income tax. The total loss of revenue resulting from these two reductions was estimated at £1,393,000, the reduction of income tax being responsible for £240,000. In proposing to raise the exemption limit Sir Edward Law [1] observed:

"We have reason to fear that it is in the lower categories of incomes that hardship is perhaps felt in the matter of inquisitorial proceedings on the part of assessors who possibly sometimes fix assessments at unjustifiably high rates, and we hope by raising the limit of taxation to greatly reduce and simplify the work of assessment." [2]

The raising of the exemption limit from Rs.500 to Rs.1,000 at one stroke diminished the number of assessees by more than half. The total number of assessees was 527,397 in 1902–3. It was reduced to 237,523 in 1903–4 with disproportionately little loss of revenue, for the yield of the tax fell from Rs.21,000,000 to Rs.18,200,000 during the same period. While the total number of assessees was reduced it was, however, noticed that there was a tendency towards a relative increase in the number of persons who now formed the lowest grade of income tax assessees, namely, those in the grade of Rs.1,000–1,250. This may be illustrated from the following figures relating to Bengal and Burma.[3]

[1] Sir Edward Fitzgerald Law (1846–1908) had a chequered career. He joined the Indian army in July, 1868, but left after a service of four years. He then went into business. Forced to abandon it by the conduct of his partners, he joined an English firm of Russian merchants. He acted as Consul at St. Peterburg, and also as commercial and financial attaché for Russia, Persia and the Asiatic Provinces of Turkey. In March, 1900, he was appointed Finance Member of the Viceroy's Council. He resigned his membership in January, 1905.

[2] *Financial Statement*, 1903–4.

[3] These figures relate to Part IV of the second schedule to Act II of 1886.

Year.	Bengal.		Burma.	
	Number of Assessees in the Grade Rs. 1,000–1,250.	Amount of Tax Paid.	Number of Assessees in the Grade Rs. 1,000–1,250.	Amount of Tax Paid.
		Rs.		Rs.
1902–3 . .	10,697	213,528	1,932	38,667
1903–4 . .	14,627	289,851	3,155	61,810
1904–5 . .	15,234	304,673	3,223	63,743

The same tendency was noticeable in other Provinces as well. It was apprehended that this might be the result of ill-directed zeal on the part of subordinate assessors, who perhaps thought it necessary to make up for the loss of revenue by assessing a larger number of persons than before, without due regard to their income. Accordingly, the Government of India called for an inquiry and report from the Provinces as to the real significance of this increase in number.[1] The inquiry elicited the fact that while in a few cases assessors were not judicious in making assessments and were guilty of excessive zeal, in the large majority of cases the increase was due to more careful inquiry on the part of the assessors. Owing to the raising of the exemption limit and the consequent diminution in the number of assessees, the officers had more time to scrutinize the individual cases.

Government Inquiry.

The exemption limit thus fixed in 1903 remained unaltered till 1919, when on account of high prices following the outbreak of the European War it was raised to Rs.2,000 a year.

The administration of the Income Tax Act of 1886 was on the whole a successful one. The authorities succeeded in avoiding the pitfalls of lenient assessment on the one side and the application of inquisitorial and unsympathetic methods on the other. At any rate, this may be conceded

[1] *Vide* letter No. 76788, S.R., of 8th December, 1904—*Report on the Administration of Income Tax in Bengal,* triennium ending 31st March, 1905.

Tests of Successful Administration.

that the tax did not produce anything like the irritation and administrative paralysis which some of the previous direct taxes had caused. There are two possible tests which might be applied in order to determine the success or otherwise of income-tax administration. One test is to ask what percentage of assessees objected to the original assessments made upon them. The Act of 1886 provided for an appeal [illegible] Collector in the first instance and ultimately to the Commissioner of a Division. A high percentage of objectors would prima facie show a stringent and excessive assessment. The other test which it is possible to apply is to compare the amount of the tax originally demanded with the final demand, after the appeals have been disposed of. A substantial reduction of the original demand by the appellate authority would indicate haphazard and rigorous initial assessment.

Both these tests have their limitations and must be applied with caution. For while it is true that a low percentage of objectors does indicate mild assessment, the reverse is not always true. An objection might be filed in the spirit of gambling, in the speculative belief that the appellate officer might be of lenient disposition. It might also be filed as a measure of defence to guard against possible enhanced assessments in the future. A Collector was once told by an assessee that he had objected because his neighbours had done, and that if any one of them had succeeded he would always have regretted his omission in not filing one. Similarly, in comparing the amount of the original assessment with the final demand it is necessary to bear in mind the conditions under which assessments and appeals were made. The fact that the amount of original assessment remains unaltered, even after an appeal, does not necessarily mean that some approach to accuracy has been attained. For under the Act of 1886 returns of income were not called for, and assessments were based largely upon presumptive evidence. Under such circumstances it is to the interest of an assessee to keep quiet, if the estimate of the revenue authorities is less than his actual income. If, however, the authorities err on the side of the excess

then the tax-payer comes forward with his application for appeals and reviews.

In the tables given in the Appendix E will be found figures showing for the Provinces of Bengal, North-Western Provinces (U.P. and Agra and Oudh), Bombay and Madras, (*a*) the original number of assessees, (*b*) their final number, (*c*) the number of petitions and objections filed before the Collector and the Commissioner, (*d*) the original, and (*e*) the final demand for each of the years 1900–1, 1905–6, 1910–11, and 1915–16.

These figures demonstrate that the number of objectors rarely exceeded 25 per cent. of the original number, while in the majority of cases the percentage was something like 10. The reduction of the original demand as a result of appeal was considerably less. Taking these facts in conjunction with the absence of any widespread discontent such as was manifest against the early licence taxes, it is not unreasonable to conclude that on the whole the tax was administered as successfully as one would expect under the circumstances of the time. For it must be remembered that the land revenue officers who worked the tax were burdened with multifarious duties. Minute supervision of each and every single assessment was therefore out of the question. But the broad statement may be made that over the whole field substantial justice was done.

CHAPTER IX

MODERN INCOME TAX, 1914–22

WITH the outbreak of the European War the Indian income tax entered upon a new phase of development. The primitive simplicity which characterized the tax of 1886 passed away. Elaborate changes for the most part based on the model of the British income tax coming in quick succession, made the tax much more complicated, its administration a matter of considerable difficulty, and its place in the financial system of the country far more important than it had ever been in the past. In 1916 the principle of graduation received a definite recognition, though at first hesitatingly. Its application was extended in 1917, when the super-tax came to be imposed. In 1919 the excess profits duty was imposed temporarily. In the meantime the administrative machinery had been overhauled and the system of assessment radically altered. Subsequent developments during 1920–22 carried forward the reforming movement thus initiated under the spur of financial necessity.

Changes effected during 1916–22.

The budget estimates for 1914–15 had anticipated a surplus (Imperial) of £1·25 millions. The first effect of the European War manifested itself on the exchange even before Great Britain had joined as a belligerent. On the actual outbreak of hostilities the public became panic-stricken. There was a run on the postal savings bank deposits and the demand for the encashment of notes increased considerably. The direct effects of the war on the import and export trade were no less embarrassing to the India Government. The stagnation of trade affected the receipts from customs, railways, post and telegraphs, with the result that

the anticipated surplus of £1·25 millions really became a heavy deficit of £2·7 millions.[1] In 1915–16 the Finance Member budgeted for an Imperial revenue of £49·65 millions and an expenditure of £52·42 millions, leaving the Imperial treasury in deficit to the extent of £2·77 millions. In spite of this anticipated deficit no fresh taxation was decided upon. The reasons which weighed with the Government in adopting this policy were three in number. In the first place no one had any precise idea as to how long the war was likely to last. As Sir William Meyer pointed out:

> "We do not propose on this occasion to raise any money by increased taxation. We should not hesitate to do so to meet a deficiency in revenue which promised to be of a more or less abiding character. . . . We hold that this necessity has not yet arisen, since the deficits of the current and coming years are . . . entirely the product of special and temporary circumstances."

In the second place it was felt that, in spite of the war, there was no cause for anxiety or alarm with regard to the revenue position, as the unproductive debt of India was very small. Lastly, on account of the depressed condition of trade and industries brought on by the war and the abnormal rise in the price of foodstuffs people were already hard hit, and it was not considered absolutely necessary to follow the lead of Great Britain in the matter of the imposition of fresh taxes.

With the close of the financial year 1915–16 the situation became graver. It is quite true that the deficit for the year 1915–16, which the budget had estimated at £2·77 millions, was reduced in the Revised Estimate to £2·1 millions. But this slight reduction in the anticipated deficit did not indicate any material improvement in the financial situation. For it was estimated that without fresh taxation the next financial year would again end in a deficit of over £2·5 millions. It then became evident that the time had come when a vigorous policy of taxation should be adopted, if India was to maintain her credit unimpaired. The taxes which were imposed took the shape of an increase in the

[1] *Revised Estimates*, 1914–15.

customs and excise duties, an addition to the duty on salt and graduation in the rates applicable to income tax. The general import duty was raised from 5 to 7½ per cent., the list of free imports was materially curtailed and duties were levied on the export of tea and jute. It was estimated that the increase in the customs and excise would yield a sum of £2,150,000, salt an additional sum of £600,000 and income tax £900,000, or in the aggregate a sum of £3·65 millions, leaving a surplus of a little over £1 million, a useful reserve against future contingencies.

The graduation in the income tax which the Finance Member proposed to effect left untouched the bulk of tax-payers in receipt of smaller incomes. He proposed to stiffen the rates applicable to persons in receipt of incomes of Rs.5,000 a year or more. The total number of income tax assessees in 1914–15 was 332,000. Of these, 295,000 who were in receipt of incomes between Rs.1,000–4,999, were not affected by the change. That reform along these lines had long become overdue in India could not for a moment be doubted. It is surprising to find a section of the Indian public expressing itself in favour of progressive income tax as early as 1860. When income tax was first imposed, a petition largely signed by office assistants employed under the Government urged upon Mr. Wilson the desirability of imposing taxes at rates varying from 1 to 5 per cent. instead of at a uniform rate. Mr. Wilson, however, was opposed to the idea of utilizing income tax as an instrument for bringing about a better and a more equitable distribution of wealth. He observed:

> "It is no part of the functions of fiscal arrangements to equalize the conditions of men. The lot of man is fixed by thousands of inscrutable causes, and if a Government were to attempt to produce an equality by distributing the incidence of taxation, it would undertake a risk the end of which must be confusion and disappointment to all concerned." [1]

The income tax of 1869 also imposed a uniform rate of 1½ per cent., and when in the next few years the need for extra revenue became pressing, it was obtained not by

[1] *Vide* Wilson's speech, *Legislative Council*, 14th April, 1860.

graduated taxation, but by an all-round increase in the rate from 1½ to over 3 per cent. It is quite true that the Act of 1886 introduced a slight departure from the principle of proportional taxation hitherto followed, for under this Act two rates were laid down, the one applicable to incomes of Rs.2,000 or more and the other to those below this limit. But this was certainly not graduation in the modern sense of the term. It is thus evident that one of the most serious defects of the Indian tax system as it stood before the war was that the scale turned too much in favour of the rich. No system of property taxes, or death duties, or graduated income tax which are universally regarded as fitting instruments for demanding an adequate contribution from the rich, redressed this inequality which characterized Indian finance. Fortunately, the circumstances arising out of the war enabled the Government in some measure to remove this long-standing injustice in 1916. Besides, when additional burdens were being imposed upon the poor in the shape of increased duties on imports and on salt, it is inconceivable that the richer classes should have been allowed to escape. It is, however, noteworthy that though financial necessity led to the adoption of graduated taxation, its proper place in the tax system of the country was not adequately realized. The Government were strongly urged in the Legislature to treat this new feature of taxation as a temporary phenomenon, which should be removed at the first available opportunity with the restoration of normal times.[1] But nothing in the history of this period is more striking than the appearance of successive waves of reform. Once a break with the past was made it became difficult to

[1] Thus one member of the Council observed: "It is necessary that it should be made clear that the scheme of enhanced taxation which the bill embodies is accepted by the country as a war measure; such taxation cannot be tolerated on the restoration of normal conditions." Another member said: "When it comes to the point of taxing our constituents, the people of this country, in the shape of an income tax in order that a surplus may be provided, I submit that that is going too far." It is necessary to add that Pandit Madan Mohon Malavya characterized the Finance Member's proposal as "eminently fair and reasonable" Referring to the fact that an income tax was the only direct tax which the richer classes contributed, he appealed to the Government to remit the taxes on poor rather than the graduated income tax, when the financial situation permitted of such reduction.

revert to the *status quo ante,* and far from graduation being abolished the need for extra revenue has been met, to an increasing extent, by successive increase of rates applicable to higher incomes.

The changes introduced in 1916 affected all persons in receipt of an income of Rs.5,000 or more. The scale of duties was as follows:

Income.			Rate.	Per cent. of Income taken in Income Tax.
Rs.1,000	but less than	Rs.2,000	4 pies in the rupee	2·0
" 2,000	do.	" 5,000	5 "	2·6
" 5,000	do.	" 10,000	6 "	3·1
" 10,000	do.	" 25,000	9 "	4·6
" 25,000	and over		12 "	6·2

Under this scheme of graduation, out of 37,000 persons who were affected by the increase in rates, 24,000 persons whose incomes ranged between Rs.5,000–9,999 had their taxes increased by only one pie in the rupee. Thus only 13,000 persons out of a total number of 332,000 income-tax assessees paid taxes ranging from 9 pies upwards.

On the occasion of the introduction of graduated taxes, a curious anomaly affecting companies was removed. The Act of 1886 as amended by the Act of 1903 had fixed the taxable minimum at Rs.1,000 a year, but it appears that the profits of companies, even though they amounted to less than Rs.1,000 used to be taxed in some Provinces and received exemption in others.[1] It was now proposed to remedy this injustice and place income from companies on a footing of equality with that derived from other sources. Profits of companies earning less than Rs.1,000 a year were exempted altogether. Profits above this level were taxed at the maximum rate, leaving the shareholders to claim total exemption or abatement as the case might be with reference to their total personal income.

With regard to the taxation of interest on securities a new procedure was now introduced. Under the law as it stood before 1916, holders of securities could obtain a partial

[1] *Vide Financial Statement,* 1916–17.

abatement of the tax or complete exemption from it, provided the Collector certified beforehand that the assessee was not taxable at all, or was taxable at the rate of 4 pies instead of 5 pies in the rupee. This procedure of anticipatory application for abatement or relief was now abolished. Instead the tax was collected at the maximum rate of 1 anna in the rupee, leaving the holders of securities to claim their refunds subsequently. The reason put forward in favour of this change in procedure was that it would ensure a quicker payment of interest to the holders of securities. As the Finance Member remarked in this connection :

> "The number of persons hitherto negligible—who are entitled to claim abatement in respect of income tax paid on interest on securities—will now be considerable, and the retention of the existing procedure for obtaining relief would, amongst other things, involve the risk of delay in the payment of interest."

This argument is valid so far as it goes, but delay might have been obviated by other means rather than by the abolition of a system which the holders of securities appreciated. No system of refunds however efficient can avoid the inconvenience resulting from the locking up of large sums of money for a considerable length of time. So far as the small holders of securities were concerned they found the new procedure extremely irksome.

The principle of rough assessment, which was a legacy from the days of the licence tax, was kept up with regard to miscellaneous incomes of less than Rs.2,000 a year taxable under Part IV of the second Schedule to the Act of 1886, and the graduated scale of 5 to 12 pies in the rupee was made applicable to all incomes above this limit. It may be questioned whether this system of approximate assessment should have been retained in 1916, but perhaps the time was not opportune for reform as the Government were preoccupied with the problems arising out of the war.

The graduated rates thus adopted in India in 1916 fell far short of those which Great Britain had found necessary to adopt on account of the stress of the war. During 1913–14 the English rates varied from 9*d.* to 1*s.* 2*d.* in the £. During the first year of the war the normal rate stood at

1*s.* 8*d.* in the £. In 1915 it was raised to 3*s.* in the £ and in the very next year to 5*s.* The Indian rates of 5, 6, 9 and 12 pies in the rupee were approximately equivalent to 6*d.*, 7½*d.*, 11¼*d.*, and 1*s.* 3*d.* in the £ respectively. Thus while the highest English rate was 5*s.* in the £, the highest Indian rate was 1*s.* 3*d.* only.

Apart from graduation and the minor administrative reforms described above, the entire structure of the Act of 1886 was left unaltered. An amendment moved in the Legislative Council to raise the taxable minimum from Rs.1,000 a year to 1,200 was negatived. It was pointed out in support of this amendment that its acceptance would have given relief to the people of the middle class numbering nearly 100,000, at a sacrifice of revenue which was small in proportion to the number involved. The Finance Member, however, found it impossible to accept the amendment and to sacrifice the revenue involved. "I do not think it would be right," said Sir William Meyer, "at a time when we are asking a number of people to bear enhanced taxation in one way or another, that we should start remitting a tax which has been so sanctified by custom." [1] He gave an assurance that he would consider the question of granting relief to the poorer classes as soon as the financial circumstances would permit it. This promise was redeemed in 1919 when the taxable minimum was raised to Rs.2,000 a year. Other amendments moved in the Legislative Council aimed at bringing under taxation the profits of the shipping companies registered abroad, and the income from sterling loans raised in Great Britain on behalf of India. As the question of the taxation of shipping companies required detailed consideration, the matter was postponed. The proposal to tax the income from sterling loans raised in Great Britain was abandoned, as legal difficulty stood in the way. The Law officers of the Crown gave their opinion that such loans did not technically constitute securities of the Government of India, and as long as the income from such securities was not remitted to India, it was immune from Indian taxation. Though the proposal was turned

[1] *Legislative Council*, 7th March, 1916.

down on technical grounds, there is ample justification from the point of view of economic theory for the exemption of such income. A borrowing country, in so far as it is paying the normal or current rate of interest, injures itself by attempting to tax this income.[1]

The effect of the introduction of graduation was soon visible in the increased yield from the tax. The gross collections are indicated in the following table:

Year.	Collections. Rs.
1886–7	13,691,800
1913–14	29,254,000
1914–15	30,551,000
1915–16	31,352,000
1916–17	56,596,000

Thus while the gross yield increased by a sum of approximately Rs.17,000,000 during 1886–7 to 1915–16, the effect of graduation was to increase the receipts at one stroke by something like Rs.25,000,000.

It will be noticed that the highest rate payable under the scheme of graduated taxes introduced in 1916 was $6\frac{1}{4}$ per cent. payable on incomes of Rs.25,000 or more. On the introduction of super-tax in 1917 the maximum rate was raised to $18\frac{3}{4}$ per cent. payable on incomes above Rs.250,000.

Events leading to the Imposition of the Super-tax in 1917.

A feeling had been growing for some time past that India's direct financial contribution to the war had been up to this time too meagre, having regard to the stupendous sacrifice made by Great Britain and the issues involved in the conflict. A resolution was moved in the Legislative Council on the 8th September, 1914, by a non-official Indian member to the effect that the people of India would wish to share in the heavy burden imposed on the United Kingdom, and thereby demonstrate the unity of India with the Empire. Similar sentiments were embodied in another resolution moved in February, 1915, affirming " the unswerving resolu-

[1] See Chapter XI, where the bearing of this topic on the problem of inter-imperial double taxation is discussed.

tion of Indians to support the honour, dignity and prestige of the Empire regardless of the sacrifice it may involve on them." A few months after the first-named resolution was passed, it was decided by the British Parliament that the pay and the ordinary charges of the expeditionary force sent out of India should continue to be borne by the revenues of India, just as if the forces were still employed in India. The special sanction of the Parliament was needed in view of the provisions of the Government of India Act, which prevented the application of Indian revenues for meeting the expenses of any military operations carried on beyond Indian frontiers, except for the purpose of repelling an actual invasion. So long as this provision remained on the statute book, it was not possible for India to bear any share of the cost of the military expedition sent out overseas. It was accordingly necessary to suspend the operation of this enactment temporarily during the period of the war. India's contribution under this head up to the end of the financial year 1916–17 was about £11½ millions. It was not possible for India to undertake any additional liability during the year 1916–17 in view of the prevailing uncertainty in the north-western frontier and the existence of heavy temporary liabilities. The general improvement in the financial situation due mainly to favourable trade conditions as disclosed in the Revised Estimate for 1916–17 [1] enabled India to make a more generous offer of assistance than she had done in the past; and early in 1917 the Viceroy despatched a telegram to the Secretary of State offering to make a special contribution of £100 millions to be raised by a loan. This contribution involved a recurring liability of £6 millions on the revenues of India in the shape of interest and sinking-fund charges.

The budget estimate for 1917–18 showed a surplus of £2·7 millons on the basis of the existing taxes and liabilities, without taking into account the fresh liability arising out of the special contribution of £100 millions. This estimated surplus disappeared and became a deficit of over £3 millions when the recurring liability arising out of the loan was

[1] This showed an estimated surplus of £5·7 millions.

taken into account. It was evident that fresh taxation was inevitable, as the deficit was not a temporary one which could be met by the adoption of palliatives. It was largely on this ground that the Government of India abandoned for the time being the idea of the imposition of an excess profits duty. Proposal for raising additional sums by means of a further increase in salt duty was out of the question, as poor persons had been hard hit by the increase in the price of salt. It was accordingly decided to raise the required revenue by increasing the export duty on jute, by a surcharge on the railway goods traffic, by subjecting imports of cotton textiles to a duty of 7½ per cent., and lastly by the imposition of a graduated super-tax on all incomes exceeding Rs.50,000 a year. The sanctioned scale was as follows:

For every rupee of the first Rs.50,000 of the excess, i.e., between 50,000 and 100,000	1 anna in the rupee.
For every rupee of the next Rs.50,000 of the excess, i.e., between 100,000 and 150,000	1½ annas in the rupee.
For every rupee of the next Rs.50,000 of the excess, i.e., between 150,000 and 200,000	2 do.
For every rupee of the next Rs.50,000 of the excess, i.e., between 200,000 and 250,000	2½ do.
For every rupee of the remainder of the excess, i.e., everything over Rs.250,000	3 do.

Super-tax on Undistributed Profits.

The super-tax was payable not only by individual assessees, but it was also extended to the undistributed profits of companies, firms and joint Hindu families.[1] The reason which weighed with the Government in extending the tax to the undistributed profits was that they wanted to bring under taxation the abnormal profits made as a result of the war conditions. For want of a more effective method a super-tax of this kind was decided upon. Whilst thus extending the super-tax to the undistributed profits, the Government had no

[1] Sections 2 (*b*) and 4, Act VIII of 1917.

desire to be harsh or unsympathetic. To make the tax as acceptable as possible, the Government allowed as deduction a sum not exceeding 10 per cent. of the whole profits before the taxable undistributed profit was arrived at.[1] Thus the taxable undistributed profit for the purpose of the assessment of the super-tax, in the case of a company having an income of Rs.300,000 and distributing only Rs.100,000 in dividends was Rs.120,000. This was arrived at in the following manner:

	Rs.	Rs.
Undistributed Profits	—	200,000
(i) Deduct Rs.50,000 not assessable to super-tax	50,000	—
(ii) Deduct further Rs.30,000 (10 per cent. of Rs.300,000)	30,000	80,000
		Rs.120,000

In making this 10 per cent. extra allowance the Government were actuated by two important considerations. In the first place the exemption was allowed to encourage the investment of capital in industries by allocation to them of a part of the profits earned in such industries. In the second place the Government realized that the profits had been the product of exceptional circumstances arising out of war conditions. In many cases the profits had been earned by extra wear and tear and excessive strain on machinery. No doubt an allowance was already made for depreciation before the profits were ascertained, but it was felt that a special concession was needed in view of the abnormal circumstances.

Super-tax on Joint Hindu Families.

The imposition of a super-tax on the undistributed income of a joint Hindu family gave rise to an acute controversy. The proposal was to tax such undistributed incomes precisely in the same way as those accruing to companies and partnerships (firms). This proposal met with considerable opposition in the Legislative Council. It was urged that the effect of a super-tax of this kind would be to encourage the disintegra-

[1] Section 4, Act VIII of 1917.

tion of joint Hindu families. As the scheme contemplated the exemption of such incomes of joint Hindu families as were "finally allotted"[1] to any member, it was argued that such families would be placed in an unfortunate predicament. To secure the benefit of such exemption there would be a tendency to allot to each member such amounts as were finally payable on division. The effect therefore would be separation as regards the amount allotted, which would follow a law of succession different from that applicable to the undistributed property, if any.[2] It was therefore urged that the Government should not be a party to any measure which "might interfere with the usages of the people in an indirect manner and encourage division by making it their interest to do so."[3] An amendment was therefore moved in the Legislature to remedy what was considered a real grievance. The amendment provided that the sum payable by a joint Hindu family should not exceed the aggregate of sums "which would have been payable by the several members of the family in respect of their shares of the income, if they had been divided." This amendment was largely based on the assumption that a Hindu family would always lose by remaining joint, and would not be entitled to get individual exemptions of Rs.50,000 for each person constituting such family. This argument overlooked the fact that such a family was not invariably placed at a disadvantage under the scheme of taxation proposed, for all legitimate items of expenditure, including those incurred for religious and ceremonial purposes, were treated by law as permissible deductions, and the super-tax was imposed on the balance, if any. If household expenses are allowed to be deducted, it is not difficult to show that joint families do not always improve their position as tax-payers by partition amongst the coparceners. The ultimate result in each case depends upon the number of co-sharers and the proportion of income which is saved. Thus the super-tax payable by an un-

[1] Section 2 (*b*), Act VIII of 1917.
[2] *Report of the Select Committee*—Note by Pandit M. M. Malavya.
[3] B. N. Sarma's speech—*Legislative Council*, 7th March, 1917.

divided Hindu family of five members having an income of Rs.300,000, and saving one-third of this income, is less than what would have been payable if the co-sharers effected a partition. On the other hand a family of five having an income of Rs.500,000, spending one-fifth of the income and saving the balance, would pay much more than if the coparceners had divided among themselves. Apart from the fact that it was not possible to predict that the tax always operated as a disruptive force tending to break up joint Hindu families, there was another consideration which weighed with the Government. As agricultural incomes were exempted from taxation, the only joint families which came under the operation of the super-tax were those deriving their income from trades and dealings. The exclusion of agricultural income left the bulk of the joint families untouched, and the position of joint families engaged in commerce was not materially different from that of partnerships. The one was a partnership by will, the other a partnership by custom. The line of distinction between the two being very thin, the Government decided to place them on the same footing. The amendment was therefore negatived and the original proposal was carried.

Duration of the Super-tax.

A similar fate awaited another amendment to confine the operation of the tax to the period of the war and for six months thereafter. It was argued in this connection that the provisions of the Government of India Act prevented the application of Indian revenues to any purpose unconnected with the Government of India. Since the money raised by the super-tax was necessary for the payment of interest and sinking-fund charges in connection with the loan raised as a war gift to Great Britain, it was felt that India should ungrudgingly contribute her share and loyally co-operate in the vigorous prosecution of the war. As these considerations ceased to operate after the war, it was suggested in the amendment that the tax should be regarded as a temporary war measure. This argument ignored the patent fact that interest and sinking-fund charges were more or less of a permanent character, and this was one of the reasons which had led

the Government to discard for the time being the idea of an excess profits duty. The super-tax bill was therefore passed without limit of time. Emergent necessities of the State brought the tax into being and the exigencies of finance of the post-war period justified its retention and further extension. Taken as a means of bringing large incomes under contribution the policy of levying a super-tax is unexceptionable. But there is one criticism which may be offered on the particular form of taxation adopted in India. As the tax was extended to undistributed profits of companies and partnerships, it was to the interest of businesses to distribute more in dividends than was justified by their financial position. There was, therefore, an indirect penalty on those companies and firms which wanted to strengthen their reserve funds. The long-period effect of such a system of taxation was bound to be injurious to industrial development in a country like India, handicapped for want of industrial capital. Fortunately, this defect was remedied before many years were out.

Company Super-tax of 1920.

In 1919, when the excess profits duty came to be imposed, the Government gave an undertaking that the question of so readjusting the burden of taxation as to meet this objection would be considered as soon as this duty ceased to be levied. In fulfilment of this undertaking the Government proposed in March, 1920, a new form of super-tax on companies to be imposed at the flat rate of 1 anna in the rupee on all incomes in excess of Rs.50,000 a year,[1] in place of the super-tax on the undistributed profits at rates varying from 1 anna to 3 annas in the rupee. While proposing this new form of super-tax on companies, the Government retained the existing super-tax on individuals, the members of a partnership now being seaparately taxed as individuals.

The new company super-tax now became the target of attack on the supposed ground that it amounted to double taxation of the same income. It was argued that individuals receiving dividends which had paid company super-tax at the flat rate of 1 anna in the rupee, would be called upon

[1] Section 4 (*b*), Act XIX of 1920.

again to pay super-tax on their share of individual dividends. An amendment was accordingly brought forward in the Legislature to remove what many persons regarded as an anomaly in the Government proposal. The amendment ran as follows :

" Where the income of the individual or a company assessed to super-tax includes a dividend paid by a company assessed during the year, the assessment shall be reduced by the amount of the tax, payable on the dividend at the rate of 1 anna in the rupee."

The Government were of course unable to accept this amendment ; for the new super-tax was really in the nature of a corporation tax. It was levied on the company as such on account of the special privileges enjoyed by it in the shape of corporate finance and limited liability. The Finance Member (W. M. Hailey) pointed out : " What we are putting on now is a new form of taxation, well known in many countries of Europe—a corporation tax." [1] From the point of view of economic theory also, it is not difficult to justify the imposition of a separate tax on individuals in addition to that imposed on companies. A tax on business is under many conditions likely to be amortized or capitalized, so that the individual shareholder really buys the share free of tax. As Professor Seligman puts it, " a tax on business is like a tax on land, or ought to be—an impersonal tax. There is no reason why you should not have both." [2]

The controversial question regarding the position of joint Hindu families came up for discussion again on this occasion. The provision of the Super-Tax Act of 1917, which regarded all sums expended for the maintenance of the family as permissible deductions, was liable to abuse ; for it was possible to write off as expenses large sums for this purpose. That the payment of the super-tax was being widely evaded by expedients of this character may be gathered from the fact that the super-tax on Hindu

[1] *Legislative Council*, 22nd March, 1920.

[2] *Vide* Vol. II, *Report of the Taxation Inquiry Committee*, p. 9.—Written Memorandum by Sir Josiah Stamp.

undivided families yielded in one year a sum of Rs.21,000 only in the whole of Bengal. The Government accordingly proposed to take away this privilege and place such families on the same footing as individuals. This proposal was, however, too drastic to receive the approval of the Legislative Council. An amendment was moved, which was carried, giving some relief to joint Hindu families. In the case of such families the exemption limit for super-tax was raised from Rs.50,000 to Rs.75,000 a year.[1] It was felt that the difference of Rs.25,000 would provide a safe margin and afford some compensation to these families for the loss of this privilege.

The rates of super-tax fixed in 1917 were left untouched in 1920. But the legacy of war finance combined with several other causes rendered fresh taxation inevitable in 1921 and 1922. The year 1918–19 had ended in a deficit of more than Rs.55,000,000. In 1919–20 the deficit mainly due to the Afghan War amounted to Rs.240,000,000 approximately. The monsoon of 1920 was a poor one. The economic collapse of Central Europe also deprived India of a considerable proportion of her customers. Under these circumstances, the accounts of 1920–1, swollen by many adjustments of arrear expenditure on the Afghan War and the European War, showed a deficit of Rs.260,000,000. These recurring deficits were met to a large extent by increasing the floating debt and by the issue of currency notes against *ad hoc* securities of the Government of India. But it was not possible to rely indefinitely on this course. Accordingly, in 1921, fresh taxation was decided upon and reliance was placed to a considerable extent on increase of customs duties and of income tax. In 1922, when a fresh deficit was anticipated, the same policy was pursued. On each of these occasions, the Government called upon the rich payers of income tax and super-tax to make larger contributions than they had hitherto done. In 1921 the ordinary income tax was increased up to a maximum of 16 pies in the rupee, this rate being raised in the very next

and Super-tax during 1921–2.

[1] Schedule to Act XIX of 1920.

year to 18 pies. The maximum super-tax rate was raised to 48 pies (4 annas) in the rupee in 1921, and finally to 72 pies (6 annas) in 1922. The following tables illustrate the successive changes in rates of the ordinary income tax during 1886–1922 and of super-tax during 1917–22:

TABLE I

CHANGES OF INCOME TAX DURING 1886–1922

Income.	1886.	1903.	1916.	1919.	1921.	1922.
Rs.	Pies in the Rupee.	Pies in the Rupee.	Pies in the Rupee.	Pies in the Rupee.	Pies in the Rupee.	Pies in the Rupee.
500–999 . .	4	—	—	—	—	—
1,000–1,999 .	4	4	4	—	—	—
2,000–4,999 .	5	5	5	5	5	5
5,000–9,999 .	5	5	6	6	6	6
10,000–19,999 .	5	5	9	9	9	9
20,000–24,999 .	5	5	9	9	12	12
25,000–29,999 .	5	5	12	12	12	12
30,000–39,999 .	5	5	12	12	14	15
40,000 and upwards . .	5	5	12	12	16	18

TABLE II

CHANGES OF SUPER-TAX DURING 1917–22

Income.	1917.	1921.	1922.
	Pies in the Rupee.	Pies in the Rupee.	Pies in the Rupee.
First Rs.50,000 over Rs.50,000	12	12	12
Next Rs.50,000, i.e., between—			
100,000–150,000	18	18	18
150,000–200,000	24	24	24
200,000–250,000	30	30	30
250,000–300,000	36	36	36
300,000–350,000	36	42	42
350,000–400,000	36	48	48
400,000–450,000	36	48	54
450,000–500,000	36	48	60
500,000–550,000	36	48	66
Over 5½ lakhs	36	48	72

The effect of this graduation in the ordinary income tax and of the introduction of the super-tax has manifested itself in the relatively important position which income

tax has come to occupy in the Indian budgets of the post-war period. The following table illustrates the relative positions of some of the more important sources of revenue in India during 1883–4 to 1923–4 and of Great Britain during 1922–3.

TABLE

SHOWING THE PERCENTAGE TO TOTAL TAX REVENUE [1]

	India.					Great Britain.
	1883–4.	1893–4.	1903–4.	1913–14	1923–4.	1922–3.
Land Revenue . .	53·15	46·71	42·76	35·42	20·75	·30
Consumption Taxes	28·05	29·78	34·18	35·91	45·97	28·04
Transaction Taxes, Fees and Death Duties . . .	9·47	9·59	9·39	11·07	9·28	11·04
Income Tax . .	1·32	3·39	2·92	3·52	12·30	38·11
Local Taxation .	8·01	10·53	10·75	14·08	11·70	22·51
	100	100	100	100	100	100

The change which has taken place in the relative importance of the different sources of revenue is so great that the Indian Taxation Inquiry Committee have characterized it as a revolution. Land revenue has lost the preponderating position which it occupied in Indian finance throughout the nineteenth and the early part of the present century. The position thus lost by land revenue has been gained by customs and excise on the one hand and income tax on the other. It is quite true that income tax in India cannot as yet compare with the British income tax from the point of view either of yield or of relative importance. But it must be remembered that the circumstances of the two countries are totally different and no effective

The Relatively Important Position of Income Tax in Post-war Budgets.

[1] See *Report of the Indian Taxation Inquiry Committee*, pp. 352, 363.

comparison can be made between them for a variety of causes. In the first place agricultural rents and agricultural profits are exempted from income tax in India. In the second place comparison between the two countries is liable to be vitiated by the fact that India is predominantly agricultural, while Great Britain is largely a manufacturing country. In the third place the difference in the relative position of income tax is in part due to the more successful, thorough and stringent administration of the tax in Great Britain than in India. This efficient administration of the tax is only natural in view of Great Britain's experience in this line extending over more than a century. India on the other hand has only recently taken in hand the task of grappling with the administrative difficulties inherent in an income tax.

CHAPTER X

THE INCOME TAX ACT, 1918, AND THE EXCESS PROFITS DUTY ACT, 1919

THE acceptance of the principle of graduation in the tax system of the country necessitated corresponding changes in the methods of assessment. The outstanding feature of the system of income tax administration brought into existence by the Act of 1886 was taxation at the source; each particular item of income, whether derived from salaried employments, securities, profits of companies or from other sources, being taxed separately. With the introduction of graduated taxes, the system of water-tight assessments became unworkable, and it became necessary to bring together the various items with a view to determine a rate applicable to the aggregate income. Returns from individual assessees were therefore needed, both in order to obtain greater precision and certainty in assessment, as also to avoid numerous applications for refunds which would otherwise have been made. With the introduction of graduated rates in the ordinary income tax in 1916 and of super-tax in 1917 the system of refunds could not work. The number of persons entitled to refunds of the super-tax in respect of company dividends would have been so great that the administration would have been overwhelmed with such applications.

Need for Administrative Changes.

Apart from the administrative difficulty inherent in a system based on refunds, the necessity for preventing fraud and evasion also pointed to the need for the radical reform of a system under which the payment of income tax had to a certain extent become voluntary, except in

cases where the tax could be collected at the source. Many persons competent to speak with authority on the subject seriously questioned if the existing machinery of assessment and collection was such as to ensure a strict and rigorous enforcement of liability to pay the tax. The Calcutta Import Trade Association drew the attention of the Bengal Chamber of Commerce to a report in the *Statesman* of the 7th July, 1916, of the proceedings before the Chief Presidency Magistrate, Calcutta. The report was as follows: "Puran Mall, cross-examined by Mr. Langford James, said that he dealt in jute, silver, and seeds. His profits were between ten to fifteen thousand rupees. He did not pay income tax."[1] There is no doubt that widespread evasions of this character were due in a large measure to the existing defects in the law of income tax, under which the authorities had no power to compel assessees to furnish the Government with returns of their income prior to assessment. This state of affairs was partially remedied when Acts VII and VIII of 1917 were passed. Under the provisions of the former Act, the Collector was authorized to demand a return of income, should he think it necessary to do so, from persons who had in his opinion an income of Rs.1,000 or more a year.[2] It is evident that even with the passing of this Act the Collector was not bound to call for returns in every case. The result was that considerable inequalities in taxation arose, for an income derived from several sources often paid at a lower rate than an equal amount of income derived from one source only.[3] Act VIII of 1917 gave the Collector discretionary authority to call for returns from super-tax assessees. This was a move in the right direction, but the remedy did not go far enough; for even in the case of super-tax there was no obligation to call for returns from every assessee.[4] Thus arose the

[1] *Vide Proceedings of the Bengal Chamber of Commerce*, 1916, Vol. I, p. 30.

[2] Section 2, Act VII of 1917.

[3] *Vide* statement by Sir W. Meyer, *Legislative Council*, 6th February, 1918.

[4] Section 5, Act VIII of 1917 provided as follows: ". . . The Collector . . . *may* cause a notice to be served upon him . . . requiring him . . . to furnish . . . a return in the prescribed form . . ."

need for a new law on the subject which would make it obligatory on the part of the Collector to call for returns of income from every probable assessee. Act VII of 1918 provided this requisite authority to the Collector. Section 17 (2) of Act VII of 1918 laid down as follows:

" In the case of any person other than a company whose taxable income is, in the Collector's opinion not less than two thousand rupees the Collector shall serve a notice upon him requesting him to furnish . . . a return in the prescribed form . . ."

The Collector was required to call for returns of income from all companies regardless of their income. It was only with regard to persons whose income was in the Collector's opinion less than Rs.2,000 a year that discretion rested with him as to whether such returns were necessary or not. So far as the assessment of these small incomes was concerned, it was felt that on administrative grounds the service of notice on a large body of persons would involve a great burden on the revenue staff, which would not be compensated for by material addition to the revenue. It was estimated, for instance, that in the United Provinces, out of 42,000 assessees, nearly 26,000 were in receipt of incomes below Rs.2,000. Besides, as these assessees were in humble circumstances, they were likely to find the preparation of returns irksome and difficult.

The Act of 1918 did not set out to impose fresh taxes on the people, for its main object was to amend and improve the machinery of assessment. At the same time the Government could not shut their eyes to the very patent fact that certain categories of income had hitherto enjoyed a privileged position in law. It was accordingly decided to utilize the opportunity in devising suitable methods for taxing these incomes, which in the past had escaped paying their share of taxes to the Indian treasury. For several years past it had been the practice of many foreign (non-British) businesses to set up in India fictitious companies with a nominal capital, with a view to use such companies as a means of carrying on trading operations. The parent company used to sell its stock-in-trade to these pseudo-

companies at exorbitantly high prices, so as to show very little or no margin of profit at all. By this device the foreign firm enjoyed all the advantages of trade with India, and yet avoided paying its due share of income tax. The Act of 1918 put an end to this state of affairs, for it laid down [1] that in such cases the non-resident foreign company should be chargeable in the name of the company resident in British India.

Taxation of Shipping Companies.

The taxation of the profits of the shipping companies had been one of the problems which had perplexed Indian administrators ever since 1886. The members of the Select Committee on the income tax bill of 1886 had declared themselves unable to suggest a suitable formula for the determination of the profits which foreign shipping companies made in Indian waters. Such profits were therefore exempted from taxation under the Income Tax Act of 1886. This exemption was terminated by the Act of 1918 under a rule which empowered the Governor-General in Council or the Local Government to "prescribe the manner in which, and the procedure by which, the taxable income of persons not resident in British India or of persons deemed to be assessees in respect thereof, shall be arrived at." [2] No doubt this provision left everything vague regarding the manner in which the profits were to be assessed. But the rules framed under the provisions of the Act laid down that the Indian profits of such companies should be assumed to bear the same proportion to their total profits as their receipts in India bear to the total receipts. Although the exemption from taxation of foreign shipping companies was formally terminated, it was not the intention of the Government to take any action in the matter so long as the war lasted. A notification was accordingly issued on the 28th March, 1918, exempting from income tax the profits of all non-resident shipping companies. This exemption was withdrawm in April, 1919, except as regards shipping companies registered in the United Kingdom or

[1] Section 33 (2) of Act VII of 1918.
[2] Section 43 (2) (c) of Act VII of 1918.

in any other part of His Majesty's dominions. The privileged position of these last-named companies disappeared finally with effect from the 22nd April, 1921. The delay in withdrawing this last privilege was due to the fact that correspondence had been going on in the meanwhile between the British Treasury and the Government of India regarding the framing of rules for the avoidance of inter-imperial double taxation.[1]

The Indian tea plantation companies had also been singularly fortunate in the matter of taxation. Under the licence tax of 1880 they were specifically exempted from taxation. An impression prevailed that this exemption would come to an end with the passing of the Income Tax Act of 1886, which brought under taxation all sources of income with the only exception of that derived from agriculture. It was widely believed that "agricultural income" did not include the profits from capitalistic manufacturing undertakings such as tea plantations. Legal opinion, however, came to the rescue of the industry, and it was authoritatively held that the provisions of the Income Tax Act of 1886 exempted from taxation the income derived from the cultivation and manufacture of tea, indigo, tobacco, and similar agricultural industries. The Government of India accepted this position, and the tea plantation companies continued to enjoy their immunity. The Act of 1918 also contemplated the taxation of the profits of these concerns, for it defined agricultural income as any income derived from "the performance by a cultivator or receiver of rent in kind of any process ordinarily employed . . . to render the produce raised or received by him fit to be taken to market."[2] But no rules were at first framed by the Government of India to carry out the provisions of this Act. In 1920 in the test case of *Killing Valley Tea Company*, the Calcutta High Court held that a portion of the profits of tea companies should be regarded as due to manufacturing, and as such liable

Taxation of Tea Plantations.

[1] Statement by Sir W. M. Hailey in the *Indian Legislative Assembly*, 15th September, 1921.
[2] Section 2 (1) (*b*) (ii), Act VII of 1918.

to income tax. The judgment of the Court was in the following terms:

"The earlier part of the operation when the tea bush is planted and the young green leaf is selected and plucked may well be deemed to be agricultural. But the latter part of the process (i.e., the processes in an up-to-date large-scale tea factory) is really manufacture of tea, and cannot, without violence of language, be described as agriculture."

Accordingly the Government of India framed rules laying down that 25 per cent. of the profits of tea plantations should be regarded as due to manufacturing process and hence liable to taxation. In accordance with the provisions of an Act passed in 1927 the proportion of taxable profit was raised to forty.[1]

Changes with regard to Depreciation Allowance.

The Income Tax Act of 1918 also effected important administrative improvements in the matter of granting depreciation allowance to business concerns. As the law stood before 1918, there was no uniformity of practice among the various Provincial Governments with regard to rules laying down the permissible allowance for wear and tear and the depreciation of machinery, buildings, or plant. The result was that competing concerns carrying on identical business in different Provinces often found themselves treated differently. Not only did the rules relating to depreciation vary in different Provinces, but even within a Province there was a lack of continuity of policy in regard to them. To quote only one instance: a representative of the jute mills had an interview in 1889 with the then Collector of Income Tax, Calcutta, and the parties came to an agreement that a deduction of 5 per cent. per annum was to be allowed for depreciation of capital. This rule was consistently followed till 1892, when an order was passed by the Bengal Board of Revenue practically denying the validity of such an arrangement. It was then decided by the Board that the mills would have to show depreciation in their accounts before they could obtain such allowance.

[1] *Vide* section 2, Act XXVIII of 1927, and Rule 24 of the *Indian Income Tax Rules* (1928).

Of course, there was nothing unjust or inequitable in the order itself; but the fact cannot be overlooked that the mills had for a number of years been habituated to a different arrangement, and naturally resented this new ruling as an encroachment on their rights.[1] To put an end to this diversity of practice, the Act of 1918 laid down that the profits of companies should be computed after making an allowance for depreciation of plant. This allowance should be fixed by the Local Government subject to the approval of the Governor-General in Council at a sum not exceeding a fixed percentage on the original cost.[2] If in any particular year the earnings were not sufficient to claim the full allowance admissible under the rules, a company was permitted to carry forward the balance to be claimed in subsequent years.[3]

Another very important change which the Act of 1918 inaugurated was with regard to the system of assessment.

The System of Adjustment and Assessment.

Before the passing of the Income Tax Act of 1918, assessment in respect of current year's income was made primarily on the income of the previous year. If, however, the actual accounts of any year disclosed an income less than that of the previous year, the assessee was entitled to refund of the excess paid to the Government. This provision was unsatisfactory, for it was one-sided in its operation. There was no provision in the law which enabled the income-tax authorities to realize the balance of the income tax due from an assessee, if his actual income in any particular year was greater than that in the previous year. The result was that assessees put in claims for refunds when it was to their interest to do so, but kept silent when their actual income was greater than that on which they had been assessed. This anomalous position was put an end to by the system of adjustment with actual income. If the income in any year was greater than that on which the tax had been imposed, the

[1] *Vide* letter from the Bengal Chamber of Commerce to the Board of Revenue dated 26th February, 1894—*Report of the Bengal Chamber of Commerce*, 1894–5, Vol. I.

[2] Section 9 (2) (vi) of Act VII of 1918.

[3] Section 9 (2) (vi) proviso (*b*).

Government were entitled to the excess tax. If, on the other hand, the accounts showed the reverse, the assessee was entitled to a refund.[1]

This system of provisional assessment and subsequent adjustment, which the Act of 1918 introduced, gave rise to considerable administrative difficulties. It threw a heavy burden on the assessing officers and caused a good deal of trouble to the assessee. Every year two assessments had to be made; one a provisional one in respect of the current year's income, and the other a final one in respect of the previous year's ascertained income. In some Provinces it became the practice to issue two distinct notices in respect of these two different assessments. This procedure added to the routine work of the office staff. The commercial community also found the system inconvenient. There are many businesses in which profits fluctuate very widely, a year of exceptionally high profits may be followed by a particularly lean year. In such concerns the assessees had to pay twice the income tax on the profits of the preceding year and then wait for another year to apply for refund.[2] As the adjustment system was found to be unworkable in practice and also unpopular, it was abolished in 1922.

These various changes effected by the Act of 1918, aiming at the removal of inequalities and anomalies in the assessment of income tax, received the unanimous assent of the members of the Legislature, who evinced a desire to strengthen the hands of the Government in their efforts at adjusting the financial machinery. Unfortunately, this harmony between the Legislature and the Executive came to an end when the discussion turned on section 4 of the draft bill. The section ran as follows:

> " Agricultural income shall not be chargeable to income tax. But the net amount of such income in excess of Rs.1,000 which has been received by an assessee in the previous year shall be taken into account in determining the rate at which the tax shall be levied on any income otherwise chargeable to income tax under this Act."

[1] Section 19 of Act VII of 1918.

[2] *Vide* letter from the G. of I., No. 3014 F. of 1st December, 1920, to all Local Governments and to the Bengal Chamber of Commerce.

It will be noticed that this provision in no way affected the exemption of agricultural income from income tax established by the Act of 1886. The only object of this section was to lay down that, in determining the rate applicable to non-agricultural income, agricultural income in excess of Rs.1,000 a year should be taken into account. This proposal was eminently fair and equitable, for it purported to lay down that a rich agriculturist deriving an income from professions, trade and industry should not get the benefit of a low rate meant only for the poorer sections of the community. As the Report of the Select Committee on the draft bill pointed out : " We are clearly of opinion that such an arrangement is a necessity if graduated income tax is to be collected on an equitable basis. It seems to us to be quite unjustifiable that a person whose net agricultural income is Rs.10 lakhs and whose income from business is Rs.1,000 should pay on the Rs.1,000 at the rate of 4 pies, while a trader whose sole income is Rs.25,000 from trade will pay on that income at the 1-anna rate." The landlords and their supporters in the Legislature construed this proposal as a move on the part of the Government to do away with the permanent land revenue settlement of 1793, as an attempt to introduce by back door the taxation of agricultural income. It was described as " a thin edge of the wedge," as a feeler in order to ascertain whether the *zemindars* were prepared for a new provision in the shape of a tax upon agricultural income. The late Sir Surendra Nath Bannerjee took up on this occasion an attitude which surprised even many of his most ardent admirers. In pointing out that the proposal had given rise to genuine concern, anxiety and alarm among the *zemindars*, whom he described as the bulwark of the British Indian Empire, " patriotic, loyal and devoted men who will stand by the Empire at any sacrifice, any hazard, any cost," he appealed to the Government as practical administrators not to be carried away by considerations of justice alone. He remarked :

Agricultural Income—its Relation to Non-agricultural Income.

" You may be fired with enthusiasm for justice and truth, and sublime things of that kind. But you are men of the world,

you are statesmen, you are administrators. Expediency is the great law which we follow, and the claims of justice have sometimes to be postponed in deference to the demands of expediency."[1]

Other speakers in condemning the proposal apprehended that it would discourage commercial and industrial enterprise on the part of the landlords, and urged that the time was inopportune for imposing a fresh tax on agricultural income and thus prevent an influential section of the people from taking part in the industrial development of the country. The proposal was also criticized on the ground that it would sanction the levy of an oppressive indirect tax on agriculture, and that it would seriously affect the petty proprietors and tenants.

The opposition which this provision encountered was so great that the Government, though convinced of the expediency and justice of their proposal, decided to leave the question to the free votes of the Legislature. The result was that this provision of the bill was negatived by 30 votes against 25. It was in vain that the Finance Member and the Law Member pointed out that the Government had no intention of putting a burdensome tax on agriculture generally or on the small proprietors particularly. The safeguard which was proposed that in estimating total incomes, agricultural incomes of less than Rs.1,000 a year would be omitted, would have left untouched the mass of ordinary *ryots* and tenants. Only the rich agriculturists deriving an income from trade, industry, business and profession would have been brought under taxation at a higher rate in respect of their income from these sources. Referring to the rich agriculturist the Law Member said:

" We are going to leave in his right pocket the overflow of rupees and gold *mohurs* which are derived from land. We do not want them; but we are going to take a little more out of his other pocket. This is not indirect taxation of the right-hand pocket."

The charge levelled against the Government of India of attempting to violate the pledge of the permanent settle-

[1] *Legislative Council*, 14th March, 1918.

ment does not bear a moment's scrutiny; for it must be remembered that agricultural incomes had been twice taxed in India in 1860 and 1869 in spite of that pledge. There was, therefore, not a shadow of justification in the statements which were repeated *ad nauseam* that the Government were guilty of breach of faith in bringing forward this proposal. Besides, the idea was not so novel as many of the critics supposed. For the Bengal Board of Revenue had laid down shortly after the passing of the Act of 1886, that agricultural income should be taken into account in determining the question whether a person was liable to income tax at all or the rate at which he should be assessed. If a person had an income from agriculture amounting to Rs.600 and was in receipt of a salary of Rs.400 a year, thus bringing his total income to Rs.1,000, he was liable to be taxed on his salary, although the salary taken by itself was below the exemption limit as fixed in 1886. It is quite true that the law had exempted persons whose "income from all sources" was less than Rs.500 a year. But the Board of Revenue in Bengal had interpreted the expression "all sources" to mean all sources whether taxable or not.[1]

The proposal embodied in section 4 of the bill merely sought to extend the practice prevalent in Bengal to other Provinces. But the vested interests of the landlords stood in the way of reform. The argument that the carrying out of this reform would discourage industrial enterprise on the part of the *zemindars* was not perhaps seriously put forward, but it shows to what straits the critics were reduced in making out their case. The promotion of trade and industry has never been a characteristic occupation of the Indian *zemindars*. There are of course exceptions to this, but these exceptions have never been numerous, nor have the investments of *zemindars* in industries been of such a magnitude as to entitle them to be called captains of industry.[2]

The lack of unanimity between the Executive and the

[1] *Vide* speech by Mr. F. J. Monahan, *Legislative Council*, 14th March, 1918.
[2] *Vide Legislative Council*, 14th March, 1918.

Legislature was not confined to this aspect of income-tax administration alone. The attempt made on this occasion to remove what must be regarded as one of the striking defects in the Indian income-tax law, arising from the absence of any popular element in the work of assessment, disclosed a radical difference in the outlook of the two parties. The result was that the existing state of affairs was maintained.

Use of Non-official Agency in Income-Tax Work.

In Great Britain it is the practice to enlist the honorary services of non-officials with a view to obtain adequate and equitable assessment, and at the same time to ensure the smooth working of the tax. With the exception of the Income Tax Act of 1860, which provided for the appointment of Special Commissioners in the Presidency towns and of *Panchayets* in other areas, Indian income-tax law has never contemplated the appointment of machinery of this kind, although informally local non-officials have been consulted in some Provinces. On the occasion of the passing of the Income Tax Act of 1918, an amendment was moved to the draft bill providing for the appointment of local committees with powers to override the decision of the Collector in the matter of income-tax assessment. The amendment was as follows:

> "The local Government shall from time to time appoint in each district two or more persons who are not Government servants, who shall be styled assessors for the purpose of assisting the Collector in any inquiry under section 18. It shall be optional to any person who has been served with a notice under this section to require that his case shall be adjudged by the Collector and assessors. . . . In the case of a difference of opinion, the opinion of the majority shall prevail." [1]

The proposal embodied in this amendment went farther than that suggested in a non-official resolution moved in the Indian Legislative Council in 1914. The resolution of 1914 urged the creation of boards composed of non-official gentlemen nominated by revenue heads of districts. This board was to act merely in an advisory capacity, with no power to override the decision of the Collector. The

[1] *Vide* amendment moved by Mr. B. N. Sarma.

Provincial Governments when consulted on the subject condemned the proposal, and the Government of India issued a comprehensive resolution pointing out that it was customary on the part of the Provincial Governments to employ non-official agency in an informal way in connection with income tax assessment, and that no further action was called for.[1] The chief objections urged by the Provincial Governments against the creation of advisory boards were the following:

(i) Business men would have strong objection to disclosing their accounts and information regarding their financial credit to outsiders.
(ii) Difficulty would be experienced in obtaining men of requisite standing to serve as assessors in local areas.
(iii) Individuals are often found by experience to be unwilling to give advice in a public and formal way.
(iv) Advisory boards would experience a difficulty in discharging their duties, because of conflicting influences brought to bear on them. The pressure brought by the assessors and the pressure from the Government would make their position difficult.
(v) The system would weaken the sense of responsibility of the income-tax collectors.

That these difficulties were exaggerated will be realized from the fact that they were not peculiar to advisory boards, for some of the objections could with equal force be urged against other popular institutions, e.g., the institution of trial by jury, the creation of union boards, village *panchayets*, etc. Yet these difficulties have not prevented the Government from giving these institutions a trial.

The system of associating in an informal manner local official committees was given a fairly prolonged trial in the United Provinces during 1896–1908, and was a success both from the financial as well as the administrative standpoints. By the year 1898 local committees were tried in as many as 38 out of 48 districts in the Province and were found useful in 29. The success of the system led the Board of Revenue to make the following observations:

[1] *Vide* Resolution No. 1287 F Simla, dated the 11th August, 1915.

"It is no longer open to question that worked with discretion and tact, the system affords a most valuable aid in assessment, especially in the direction of fair distribution and it helps to mitigate what is one of the greatest of the popular objections to the tax." [1]

The Lieutenant-Governor of the Province, on a consideration of all the opinions elicited from the district officers, came to the conclusion that the system should be extended generally throughout the districts in the Provinces.[2] In 1905, after these local bodies had been in operation for nearly ten years, the Board of Revenue again commented favourably on them. It observed: "Non-official assessors were consulted in most districts and the assistance rendered by them was found to be generally useful, particularly in cities and large trading centres." [3] In the light of this experience, it was not unreasonable to ask for the adoption of the next important step in advance by providing for the formal appointment of assessors with powers co-ordinate with those of the Collector. The setting up of a machinery of this kind would certainly have been an improvement upon the old informal agency, for it is a matter of common experience that a man who is charged with responsibility and is accorded a position of trust is more likely to take his duties seriously than when he is consulted casually by the Collector. At any rate the Government should have been prepared to give the proposal a trial in the Presidency towns and other industrial areas. It is true that many Indian business men are opposed to this method, owing to the risk of the disclosure of their accounts and of their financial credit to outsiders. But it is well to bear in mind that if the opinion of the business men were always allowed to prevail, many of the reforms connected with income tax administration which have been carried out would hardly have been possible. To take only one instance, the provision of the Act of 1918 relating to the compulsory submission of returns

[1] *Report on the Administration of Income Tax for the North-Western Provinces*, 1898–9.

[2] *Vide* Resolution 290/XIII—601 A of 1899.

[3] *Vide triennial Report on the Administration of the Income Tax, U.P.* year ending March, 1905.

met with vigorous opposition from some business men.[1] That opposition has sensibly diminished to-day, and business men have reconciled themselves to the inevitable. Besides, this objection could have been met by making the appointment of non-official agency optional at the instance of the assessee. These considerations, however, did not appeal to the Government. They were not prepared to reconsider the attitude which they took up in 1915. Sir William Meyer on behalf of the Government observed: "I stood by the policy enunciated in 1915, and I entirely stand by it now. We want as far as possible to get non-official association with the Collectors' assessments, but it must be of an informal and elastic character." The amendment which suggested the appointment of assessors with powers co-ordinate with those of the Collector was therefore withdrawn.

The Act of 1918 was the outcome of the first systematic attempt made in the history of income-tax legislation in India to overhaul the methods, the basis and the machinery of assessment. The Government of India followed up this with measures for strengthening the administrative staff. These will be described in a subsequent chapter.[2] It was expected that a progressive improvement would be effected in the direction of enforcing liability to the tax. This expectation was fulfilled, for the appointment of a whole-time staff was followed in every case by a steady increase of revenue. In many respects, as we have already seen, this Act effected distinct improvements on the old and antiquated system and, while it was largely the outcome of the introduction of graduated rates, the improved machinery brought into existence as a result of this Act made possible the imposition of another new tax in India —the excess profits duty.

To trace the genesis of the Indian excess profits duty imposed in 1919,[3] it is necessary to carry our mind to

[1] *Vide* statement by H. F. Howard, *Legislative Council*, 10th September, 1919.

[2] Chapter XVI.

[3] Act X of 1919—*An Act to impose a Duty on Excess Profits arising out certain Businesses.*

April, 1918, and recall the circumstances connected with the meeting of the war conference held in Delhi. The conference opened with a message from His Majesty the King-Emperor, in the course of which His Majesty was pleased to observe :

Events leading to the Imposition of the Excess Profits Duty.

"I look confidently to the deliberations of the conference to promote a spirit of unity, a concentration of purpose and activity and a cheerful acceptance of sacrifices without which no high object, no lasting victory can be achieved."

The deliberations of the war conference were mainly concerned with the question of increasing the assistance which India could render to the Empire, either by the provision of increased man power or by the development of material resources in matters connected with the war. The question of additional financial assistance was mentioned, but it was decided to postpone consideration of the matter till the Legislative Council had met and expressed its wishes in the matter. As the Viceroy said on this occasion :

" How India can best render financial assistance is a matter which must engage our earnest attention. Later on when the position is clearer than at present we propose to consider in conjunction with the Legislative Council, for this is a matter essentially in its sphere, how far it will be feasible for India to increase the direct financial contribution she has already made to His Majesty's Government."

In accordance with this arrangement the following resolution was moved in the Legislative Council in September, 1918 :

" That this Council recognizes that the prolongation of the war justifies India's taking a larger share than she does at present in respect of the cost of military forces raised or to be raised in this country." No fresh direct contribution of the kind made in 1917 was thought appropriate on this occasion, but instead it was decided that India should agree to bear the normal cost of 200,000 additional troops. The cost of these men would under ordinary circumstances have fallen upon His Majesty's Government in Great Britain, and if India took up the current charges the British Government would be relieved to that extent. On the assumption that the war would

continue till March, 1920, it was estimated that this gift would cost India a sum of £45 millions in the aggregate. The charges of the troops were estimated to amount to £12·7 millions in 1918–19, £14·7 millions in 1919–20, and £7·7 millions in 1920–1. In addition to these sums there were the pension charges of the troops. The war happily ended long before the time estimated by Sir William Meyer, and the cost which India had to bear was proportionately reduced. It was estimated that India's contribution under this head was not likely to exceed £30 millions in the aggregate. Sir William Meyer had expected that he would be in a position to meet the first year's contribution of £12·7 millions out of current revenues. Unfortunately, owing to famine and other difficulties this was not found practicable and recourse was had to loans. For the year 1919–20 the Government found themselves with a liability of £8¾ millions and fresh taxation was necessary. The Government decided upon the imposition of an excess profits duty.

The Theoretical Justification.

During the course of the war, excessive war demand for a variety of goods, combined with a shortage of supplies, had enabled many business men to reap excessive profits. Temporarily many producers found themselves in the position of quasi-monopolists. They therefore seized this opportunity with advantage. The Governments of both belligerent and neutral countries hard pressed for funds saw in these profits a good target of attack. Thus it is that an excess profits duty or a tax on war profits found a place in the financial system of many European countries. The movement for the levy of excess profits duty originated early in 1915 in neutral Scandinavian countries which, as exporters of food-stuffs to Germany, had reaped exceptionally high profits.[1] The question of the imposition of an excess profits duty had been discussed in India at the time of the introduction of increased taxation in 1917–18. But the Government were forced to abandon the idea, largely on the ground that the elaborate administrative machinery needed for the successful administration of the tax did not exist at the time. The situation had

[1] *Vide* Robinson, *Public Finance*, pp. 68–9.

improved to a considerable extent due to the reforms inaugurated since the passing of the Income Tax Act of 1918. The Government had added to the establishments and increased the efficiency of the income-tax machinery through which the excess profits duty was going to be worked.

The criticisms which were directed against the proposal were of two different types. On the one hand it was urged that since the war had terminated there should be no further special taxation. On the other hand, many critics suggested an alternative in the shape of a modified super-tax levy. The former proposal was obviously based on the belief that war expenses automatically cease with the cessation of hostilities. "War," said Lord (then Sir James) Meston in February, 1918, "is not like a game of chess which you can finish, put away the chessmen and fold up the boards and walk off. War is an evil of which the consequences remain, and those consequences have got to be paid for by whatever name we call the requisite taxation." The alternative proposal for the levy of a modified super-tax was open to the objection that it would have entailed the imposition of taxes at rates higher than those necessary in normal circumstances. Such a tax at an unnecessarily high rate would have prejudicially affected the incentive to production.

Accordingly, the Government proposed an excess profits duty on all businesses which during the year 1918–19 had earned profits in excess of Rs.30,000. Profits in the accounting period in excess of a standard sum to be fixed by law were to contribute 50 per cent. of this excess.[1] Income from agriculture, offices, employments and professions were exempted. Business concerns which paid the British excess profits duty also received exemption.[2] Two questions of importance arose in connection with the imposition of this tax. One was the determination of the "accounting period" over which the profits were to be estimated. The other was the settlement of the standard profits beyond which the gains were to be taxed.

The Main Features of the E.P.D. Act, 1919.

[1] Section 4, Act X of 1919. [2] Schedule I, Act X of 1919.

The first question was at once difficult and important. The Government bill originally provided that the profits were to be estimated up to the end of March, 1919, or to some other date in the course of the twelve months preceding March, 1919, as was the end of the company's usual business year. This proposal disclosed defect of a serious nature. A company which had made up its accounts to the end of March, 1919, was likely to have less profits than one which closed its accounts in, say, September, 1918. For in the former case the company had to contend with the fall of demand and low prices following the armistice, whereas a company which had closed its accounts in September, 1918, had twelve months of uninterrupted prosperity behind it. The Select Committee on the bill met this difficulty by giving an option to those companies which had closed their accounts earlier than March, 1919. The option is thus described in section 5 (*b*) of Act X of 1919:

"The profits of a business in the accounting period shall, at the option of the person by whom the excess profits duty in respect of that business is payable, be or deemed to be:

"(*b*) when the accounting period in respect of the business ends on any date other than the 31st March, 1919, and the accounts of the business are made up for an additional period ending on the said 31st March, a sum which bears the same proportion to the taxable income of the total period (such taxable income being ascertained as nearly as may be in accordance with the provisions of the said Act) as a period of one year bears to the total period."

In other words, a company which had closed its accounts earlier than March, 1919, had the option of making up its accounts up to March, 1919, and of paying excess profits duty on a proportionate part of its total income. A company closing its accounts, for instance, in September, 1918, would pay excess profits duty on twelve-eighteenths of its profits earned during the period—1st October, 1917, to 31st March, 1919.

The second question which required solution was the determination of the standard profits. The draft bill proposed to take as the standard, the average of the profits in respect of which a company had paid income tax in the

two years before the declaration of the war and two years after that event. The underlying idea was to take as the basis of the estimate two years of normal profits before the war and two war years of exceptionally high profits. In the alternative, companies were given the option of paying excess profits duty on the basis of an assumed yield of 10 per cent. on their capital. Here, again, the Select Committee were compelled to suggest alterations to meet several difficulties. In the first place it was realized that a stereotyped basis of two pre-war and two war years was not suitable for all businesses. For there were several companies which had derived no additional profits as a result of the war. On the contrary, their earnings after the hostilities were decidedly lower than those before the war. Such companies would have been adversely affected had the proposal embodied in the draft bill been accepted. In the second place there were companies which, not having paid income tax in any one out of the four years mentioned above, had no alternative but to pay excess profits duty on the basis of a conventional yield of 10 per cent. on their capital. To meet these cases the Select Committee were obliged to offer a wide range of options, so that a company could select any basis which suited it best. For instance, companies were given the option to pay 10 per cent. on their capital.[1] They could also estimate their standard profits on the basis of their average earnings during the years 1913 and 1914, provided they had paid income tax in those years.[2] Again, companies if they liked could ask for an estimation of their standard profits on the basis of their earnings in 1913, 1914, and any two out of the three years 1915, 1916, and 1917, provided they had been assessed to income tax in these years. It may be noted in this connection that the Government of Great Britain, when they imposed an excess profits tax in September, 1915, did not find it possible to be so generous in their treatment of companies as the Government of India. In Great Britain the standard profit was the average of the profits made in any two of the last three years before the out-

[1] Section 6 (1) (*a*), Act X of 1919. [2] Section 6 (1) (*b*) (i), Act X of 1919.

break of the war.[1] The result under this arrangement was that companies, which reaped exceptionally high profits during the war as a result of the introduction of economy and good management, found themselves more heavily taxed than those which had effected improvements before the war. In India hardship of this kind was avoided by giving the companies options regarding the manner in which their standard profits were to be estimated. Then again, in India the smaller companies were exempted from the tax inasmuch as it was payable only by companies making a profit of more than Rs.30,000 during the accounting period.[2] The British rates were higher and the tax also lasted longer. Great Britain started with a rate of 50 per cent. on the excess over the pre-war standard. In 1917–18 the rate mounted to 80 per cent. In the first budget after the war the rate was reduced to 40 per cent., and in 1921 the excess profits duty was abolished.

Act X of 1919 contained generous rules regarding depreciation allowance. Discretionary authority was given to the Collector to modify the assessment in particular cases in which a rigid application of the rules would cause hardship. Thus companies which had to postpone their repairs and renewals in consequence of the war, or which had suffered exceptional depreciation of their assets, could apply to the Collector for a modification of the assessment on these grounds. Again, many business concerns are under a legal obligation to invest a portion of their resources in Government securities. The war had caused a depreciation in the value of these securities to a considerable extent. For income-tax purposes it was not permissible to take this depreciation into account. But for estimating the excess profits duty this restriction was relaxed, and the law permitted specially considerate treatment of these securities. Companies unable to use after the war, plant and machinery which they had installed for war work, also received

[1] Section 40 (2), Finance (No. 2) Act, 1915 (5 & 6 Geo. V, c. 89).

[2] In Great Britain the profit initially exempted was £200—*Section 38, Finance (No. 2) Act*, 1915. In 1917 when the tax was raised to 80 per cent. the allowance was increased—*Section* 26 (4), *Finance Act*, 1917. See also *The American Economic Review*—Supplement, December, 1920.

exceptional treatment. The only restriction which the law placed on the power of the Collector in this respect was that he could not, without the previous sanction of the Commissioner, modify the assessment in such a way as to reduce the excess profits duty payable by more than 25 per cent.[1]

One feature of the excess profits duty which demands more than a passing notice is the provision relating to the appointment of a Board of Referees composed of non-officials, who were vested with the power to hear appeals at the option of the assessee. A person who was dissatisfied with the assessment of the Collector was entitled to appeal to the Chief Revenue Authority of the Province, or if the assessee so desired, the matter could be referred to a Board of Referees composed of three or, in cases of special difficulty, of four persons. Such Board was to consist of at least two non-officials having in the opinion of the Provincial Government adequate business experience.[2] It will be recalled that when a similar proposal was mooted at the time of the passing of the Income Tax Act of 1918, business men were opposed to the idea as they apprehended that the appointment of non-official assessors might lead to a disclosure of the state of their credit On this occasion, however, the proposal did not encounter any opposition. On the contrary, it was welcomed as tending to bring about harmonious relations between the Government and business men. As Sir Dinshaw Wacha put it, " the tax-payers and the tax-gatherers are to be brought together, the lion and the lamb will drink water at the same fountain, and, of course, in that way there will be a good deal of harmony and peace." [3]

The problem of the relations of the excess profits duty to super-tax and income tax presented a great difficulty. The Act laid down that no assessee would be made liable to both the super-tax and the excess profits tax.[4] Of these two taxes, the one yielding the higher revenue was chargeable. As Sir James Meston humorously remarked

[1] Section 7, Act X of 1919. [2] Section 8, Act X of 1919.
[3] *Legislative Council Proceedings*, 10th March, 1919.
[4] Section 19, Act X of 1919.

in this connection: "The Finance Department is often twitted with the maxim 'whichever is less.' On the present occasion we are prepared magnanimously to reverse that motto and take whichever is greater." The excess profits duty was also allowed to be treated as business expense.[1] In other words, it was provided that no income tax would be payable on that part of the profits of the business which was payable as excess profits duty. It was this provision of the law which gave rise to an anomaly. Businesses exercising the option to pay excess profits duty in preference to super-tax were allowed to treat this payment as a permissible deduction in connection with the assessment of income tax. On the other hand, those who chose to pay super-tax were not allowed to treat this payment as a charge on their business. No satisfactory solution could be devised with a view to afford relief to this class of assessees, and the commercial community had to rest satisfied with the assurance given by the Finance Member to review and rearrange the whole system of taxes on incomes when the excess profits duty ceased to be levied.

As already pointed out, the proposal of the Government was to take 50 per cent. of the profits in excess of the standard sum. Notices of two amendments were sent in the Legislative Council having for their object the reduction in the rate of the tax, but nothing tangible came of these. One of the amendments directly proposed to reduce the rate of the tax to 33 per cent. of the excess profits. The other amendment sought to reduce the rate in an indirect fashion, by laying down that, in the event of the yield of the tax exceeding Rs.110,000,000, the excess should be refunded *pro rata* amongst the contributors. This proposal could not be accepted for two main reasons. In the first place, the amendment virtually proposed a remission of taxation, and as such it was out of place in a bill of which the avowed object was to raise money. In the second place the acceptance of this principle would have created an embarrassing precedent. Obviously, when the Government were hard pressed for funds, the time

[1] Section 20, Act X of 1919.

was most inopportune for starting an innovation of this kind.

The duty was imposed for one year only, though the Government declined to give any definite promise regarding the future of the measure. The attitude of the commercial communities—Indian and European—was definitely hostile to it. The representatives of the Bengal and Bombay Chambers of Commerce in the Legislative Council, though personally in favour of the tax, thought it their duty to express the views of their constituents in unmistakable terms. It was urged that the imposition of this tax was likely to imperil the success of the loan which the Government wanted to float at the time. Other critics apprehended that it was not only likely to retard the growth of indigenous industries, but might also have the effect of preventing the importation of foreign capital necessary for reconstruction purposes after the war.[1] These fears proved groundless as the Indian excess profits duty, unlike its British prototype, lasted for one year only and was repealed in 1920. The yield of the duty in the various Provinces is shown in the table below. The receipts credited in the accounts for the year ending 31st March, 1921, and 1922 represent collections of arrears :

Provinces.	Year ending 31 March, 1920.	Year ending 31 March, 1921.	Year ending 31 March, 1922.
	Rs.	Rs.	Rs.
India	43,504	401,205	—
N.W.F. Province .	96,800	—	30,755
Madras	2,142,128	3,832,284	727,564
Bombay	27,807,499	6,158,826	1,103,085
Bengal	51,382,284	6,956,880	201,462
U.P.	3,276,758	725,654	26,349
Punjab	694,035	423,648	49,909
Burma	3,923,846	285,277	—
Behra and Orissa .	224,608	30,726	13,881
C.P. and Berar . .	2,668,908	—	—
Assam	20,124	1,406	—
	92,280,494	18,815,906	2,153,005

[1] Sir G. Chitnavis' speech—*Legislative Council*, 19th March, 1919.

Indian E.P.D. d E.P.D. Britain.

The British excess profits duty yielded on an average a little over £192,000,000 a year. But no precise comparison is possible between Great Britain and India, as the circumstances of the two countries were entirely different. Not only did the excess profits duty in India differ from that in Great Britain as regards the magnitude of the yield, but also in another important respect. It is probable that in Great Britain the tax may have indirectly operated as a factor in putting up prices. It is no doubt true that the Government attempted to isolate the normal profits and to tax gains beyond this sum. From the point of view of theory there is no reason why such a tax should have caused a rise of prices. But it is necessary to bear in mind that it was not possible to separate completely the windfall element. Then, again, in estimating the excess profits, no regard was paid to the fact that a given amount of money profits represented less real profits than before.[1] Under such circumstances the excess profits duty may have had indirect effects in bringing about high prices in Great Britain. In India, on the other hand, the tax was imposed only once. It was not, therefore, possible to pass it on to the customers.

But while the two taxes differed from each other in these respects, the method of the imposition of the tax and the underlying theoretic justification were the same in both countries. The excess profit taken by itself was regarded as the taxable unit unrelated to any other factor, as, for instance, the circumstances of the individual shareholder or partner, and the tax was imposed at a flat rate proportional to the amount of the excess. The economic justification for a levy of this nature may be found in the benefit principle, if it is assumed that the State itself is responsible for the creation of circumstances which make it possible for these excess profits to be earned. If the excess profits are due to increased output at pre-war prices or to the pre-war output at enhanced prices, the State is justly entitled to claim a share in the excess. The duty

[1] Pigou: *A Study in Public Finance*, p. 179.

under these circumstances may be regarded as " a business expense, a royalty, a condition precedent to the making of a profit." [1]

[1] *Vide* Sir J. Stamp's article on " The Taxation of Excess Profits Abroad " —*Econ. Journal*, March, 1917.

CHAPTER XI

THE INCOME TAX LEGISLATION OF 1922—THE CONCEPT OF TAXABLE INCOME

THE Income Tax Act of 1918 remained in force till 1922, when need was felt for a revision and amendment in the law. The most important single cause which necessitated such revision was the constitutional reform inaugurated by the Government of India Act, 1919. Under the new political arrangement income tax became a central source of revenue, and it became necessary to centralize the administration of the tax and to set up new machinery controlled and regulated by the Government of India. The financial difficulty of the Government of India in 1921 also pointed to the need for a reform in the Act of 1918. The monsoon of 1920, which was a poor one, continued to make its influence felt even in 1921. The depression in trade affected the receipts from railways, customs, income tax, post and telegraphs, while the high prices of foodstuffs affected the expenditure side, particularly the military expenditure. Military expenditure had also to be increased on account of extended operations in Waziristan. Labour troubles within the country, and the unsettled conditions in Russia and Central Europe, were no less important causes in contributing to the deficit of the year. Expenditure on railways was increased owing to shortage in the supply of coal, while the revenue suffered on account of stagnation in the export trade.

Causes necessitating Revision of the Income Tax Act of 1918.

Whatever may have been the causes of the deficit, there is no doubt that it placed the Government of India in a position of considerable difficulty so far as the working of

the Income Tax Act of 1918 was concerned. The stagnation in trade necessitated heavy refunds by the Government on account of payments of income tax made under the system of assessment and adjustment introduced by the Act. We have already referred to the unpopularity of this system amongst business men, as it led to hardships particularly in businesses in which profits were of a fluctuating character. If in any year the profits were large the assessee, owing to adjustment and provisional assessment for the following year which might be a lean one, had to pay twice on the profits of the good year, and then wait for another year for refund. The working of the system not only caused hardships to business men, but also led to numerous misapprehensions, for the system was not clearly understood by the rank and file of the assessees. The refunds which the Government had to make during 1921–2 in a year of heavy deficit made them realize that the system was one which required alteration. Besides, the Joint Parliamentary Committee on the Reform Scheme had recommended that the Provincial Governments should be given a share in the increase in the receipts from income tax, due to an increase in income brought under assessment each year. It was obvious that if the Provinces were to obtain a share in the receipts, it would be necessary to ascertain each year the assessed income in respect of which the income tax was collected. It would have been a matter of considerable difficulty to find this out if the adjustment system remained in operation.[1] The Government therefore decided to abolish this system, and at the same time introduce several other changes which the working in the Act of 1918 had suggested. Owing to a High Court ruling that the word "income" as used in the Income Tax Act of 1918 should mean "income actually or constructively received," Government and business men alike were placed in a position of difficulty. In the first place the meaning put by the High Court led to a restricted interpretation of those sections of the Act of 1918 which

[1] Letter from G. of I. No. 3014 F, dated 1st December, 1920, to all ---' Governments.

specifically mentioned the different classes of income liable to be taxed. In the second place the decision of the High Court caused embarrassment to those business men who kept their accounts on the basis of mercantile accountancy. There are two recognized systems of keeping accounts, viz., the receipts and disbursements accounts and income and expenditure accounts. The former is the cash basis which shows the sums actually received and sums actually paid out, while the latter is the mercantile accountancy system based on the preparation of a profit and loss account, and the comparison of the value of the stock in hand at the beginning and at the end of the year. Under the last system, whenever a sale takes place, an entry is made on the receipts side, although the sale price may not have been actually received. Similarly in the case of expenditure, an entry is made on the other side whenever the liability is incurred, although no payment may have been actually made. The interpretation put by the High Court on the word "income" rendered it necessary for assessees, who kept their accounts according to the mercantile accountancy system, to recast them on a cash basis to show the income actually or constructively received. Business men were therefore put to great inconvenience and expense in thus trying to satisfy the income-tax authorities. Need was therefore felt for such an alteration in the law as would leave the assessees the option of adopting any system of accountancy they preferred, with this reservation, however, that the system must be one regularly employed for the purpose of business.

One of the reforms which the Government of India had intended to carry out in 1918 was to secure uniformity in rules relating to depreciation allowance in connection with the estimation of business profits. With this object in view, the Act of 1918 empowered the Provincial Governments to lay down rules subject to the approval of the Governor-General in Council.[1] The result of this delegation of power was that the income tax ceased to be administered on a uniform basis by the different Provincial authorities.

[1] *Vide* section 9 (2) (vi), Act VII of 1918.

The Act of 1918 had therefore, to this extent, failed to carry out the object which the framers had in view. It appeared to the Government of India that the only remedy was the constitution of a central authority charged with the duty of administering the Act and of framing rules thereunder. These were among the most important reasons which necessitated a revision of the Act.

The Government of India decided to proceed cautiously with their task. Provincial committees were appointed which considered the subject in detail. The recommendations of these committees were referred to the All-India Income Tax Committee which sat in Simla in July, 1921. The bill as finally drafted followed very closely the report of this committee. It was then referred to a joint committee of sixteen members from the Legislative Assembly and the Council of State and, with very little modification in the Legislature, it received the assent of the Governor-General on the 5th March, 1922. This Income Tax Act [1] is the basis of the existing law and practice of income tax in India. It is therefore worth while to note its salient features before proceeding to a detailed examination of its contents.

The Main Features of Act XI of 1922.

The outstanding feature of the Act of 1922 is the separation of the administrative portion of the law relating to the income tax from the fiscal portion. All provisions relating to the basis, methods and machinery of assessment will be found in the body of the Act, while the rates of tax were for the first time separated from the Act itself and placed in the annual Finance Act. This procedure adopted by the Government was analogous to the prevailing practice in Great Britain, where the administrative provisions are contained in the Income Tax Consolidation Act of 1918, while the rates of tax are specified in the annual Finance Act and are liable to alteration from year to year. The constitutional significance of this change should not be overlooked. It means that the Legislative Assembly will have to be consulted every year on the occasion of the

[1] Act XI of 1922—*The Indian Income Tax Act.*

passing of the finance bill. This was an important step in advance of the hitherto existing practice, for under the system then in vogue the rates of income tax were more or less permanent and did not require the sanction of the Legislature every year. Thus the rates incorporated in the Act of 1886 remained unaltered till 1916, and within the space of thirty years the only occasion on which the Government had to come up before the Legislature was when the taxable minimum was raised from Rs.500 to Rs.1,000 a year in 1903. By the simple device of incorporating the rates of income tax in the annual Finance Act a great advance was made on the path of popular government.

Collection at the source, as far as practicable, has always been a characteristic feature of the Indian income tax as of the English system, and the Act of 1922 took the bold step of extending the principle further into a domain in which it did not hitherto operate. Under the Act of 1886 the tax due from any person in Government employment or in the employment of a local authority, in respect of salary, annuity, pension, or gratuity, was liable to be deducted at the source, and the duty devolved upon the officer who was to make such payments of putting the tax to the credit of the Government of India. There was no obligation of this nature on private employers. A provision no doubt existed under which Provincial Governments, by virtue of the authority delegated to them by the Government of India, could grant remissions at varying rates to those private employers who undertook to collect income tax on behalf of the Government from persons in their service. This provision was as follows:

> "The Collector may, subject to such conditions as may be prescribed, enter into an agreement with any company or any such body or association as aforesaid, or any private employer, with respect to the recovery on behalf of the Government by the company, body or association or employer, of the tax to which any person receiving any salary, annuity or pension or gratuity from the company, body, association or employer is liable under Part I." [1]

[1] Section 9 (2), Act II of 1886.

The rules prescribed under this section granted a remission to such employers of 5 per cent. if the collections were made yearly, of 3 per cent. if they were made quarterly and of 1 per cent. for monthly payments.[1] This compensation offered to the private employers was insufficient to induce them to take the trouble and expense of collecting the tax. The annual administration reports on the working of income tax in Bengal from 1886–7 onwards bear testimony to the fact that every year the number of persons who undertook this collection work went on dwindling. In 1890–1, for instance, the number of private employers in Bengal who entered into agreements under the above section fell from 403 in the previous year to 348. This apathy was not exceptional to particular year or years, but was typical of the situation as it stood under the Act of 1886. When the Act of 1918 supplanted that of 1886, no alteration was made with regard to the liability of the private employers to deduct income tax from the salaries of their employees. It was, perhaps, felt that the time was not opportune for the introduction of a radical change, particularly when some of the businesses had been hard hit on account of circumstances connected with the war. The Act of 1922 for the first time made it obligatory upon all private employers to deduct income tax from salaries at the time of payment.

While thus extending the obligation of private employers in one sphere, the Act of 1922 provided other rules by means of which companies and business men could obtain relief from a number of inconveniences to which they had been subject formerly. Reference has already been made to the abolition of the adjustment system, and also the option given to assessees to cast their accounts either according to the mercantile accountancy or according to the cash system. The Act of 1922 also removed one of the chronic grievances of companies which were domiciled in Great Britain but carried on their operations in India. Ever since 1860 such companies had been subjected to double taxation in respect of the same income both in Great Britain

[1] *Reports on the Administration of Income Tax, Bengal,* 1890–2.

and in India. The law of 1922 gave statutory recognition to the principle accepted between the Government of Great Britain on the one hand and of India and of the Dominions on the other, that where income tax was charged on the same income both in the United Kingdom and in a Dominion the total relief to be given should be equivalent to the tax at the lower of the two rates of tax imposed. The history of the proposal relating to the avoidance of inter-imperial double taxation and the exact provisions relating to relief are considered in a subsequent chapter.[1] The Income Tax Act of 1922 provided relief to assessees in another important respect. The rules relating to refund of income tax were simplified, and all officers deducting income tax from interest on securities or dividends were required to issue to holders of such securities a certificate in a prescribed form stating the amount of the tax collected and the rate at which it had been collected.[2] These are points of detail, but they show the minute scrutiny to which the provisions of the new law were subjected. The Act and the rules framed thereunder evince a desire on the part of the Government to meet as far as practicable the criticisms to which the law of 1918 had been subjected. Reference may be made in this connection to another feature of the Act of 1918 which was absolutely indefensible in theory and iniquitous in practice. Under the provisions of the Act of 1918, the Chief Revenue Authority either on its own motion or on reference from any revenue officer subordinate to it, could draw up a statement of a case for reference to the High Court for the purpose of interpreting any of the sections of the Act. There was, however, no provision compulsorily requiring the Chief Revenue Authority to refer such questions at the instance of the assessee. The law simply provided that the Chief Revenue Authority, "shall so refer any such question on the application of the assessee, unless it is satisfied that the application is frivolous or that a reference is unnecessary."[3] It will be noticed

[1] Chapter XV.
[2] Sections 18 (9) and 20 of Act XI of 1922.
[3] Section 51 (1) of the Act VII of 1918.

that the law left considerable discretion to the Chief Revenue Authority in this respect.

Attention was called to this grievance of the assessee in a resolution moved in the Legislative Assembly on the 23rd March, 1921. The resolution suggested the desirability of changing the law in India, so as to bring it in conformity with the provisions of the English Income Tax Act. It was suggested that reference to the High Court might be made obligatory at the instance of the assessee on questions of law. Mr. Eardley Norton, a distinguished lawyer, criticized the existing law on the subject in words which will bear repetition. He said:

> "There is a great principle at stake here, a principle which has been consistently departed from by the Government for years past, and that principle is that no man shall be a judge in his own case. That principle has been departed from not merely on questions with regard to income tax, but in almost every fiscal question which arises between the subject and the Crown. The Government have invariably arrogated to themselves the indefensible position of first of all saddling you with the amount which they claim and then allowing you practically no appeal against that decision." [1]

The Government of India were convinced of the genuineness of the grievance, and gave an assurance that the whole question of the right of appeal would be gone into by the committee on income tax which they were going to appoint. The All-India Committee on Income Tax suggested that the Chief Revenue Authority should no longer have the power to withhold a reference to the High Court on a question of law, subject to this reservation that in order to guard against frivolous or unnecessary references, assessees should be called upon to pay a fee of Rs.100. The suggestion was approved by the Government and was accordingly incorporated in the new Act.

The main features of the Act of 1922 mentioned above show that, broadly speaking, there is a growing tendency to incorporate as much as the local circumstances of India permit many of the prominent features of English income-

[1] *Vide* debates in the *Legislative Assembly*, 23rd March, 1921.

tax administration. The centralization of administration as evidenced by the setting up of a Board under the control of the Government of India, the separation of the administrative portion of the law relating to income tax from those relating to fiscal portion, the new provision relating to appeal, the extension of the principle of collection at the source—these are striking instances of the manifestation of the force which is slowly but surely transforming the primitive Indian Income Tax Act into a statute of great complexity, predominantly based on the model of the British legislation on the subject. It is now necessary for us to enter into details with a view to inquire to what extent the tendency is visible in the detailed provisions as well. It will be convenient to commence our study with the concept of income.

The Concept of Income.

Everyone has a rough idea of what is meant by "income," but this popular concept is hardly of any use to the Government for the purpose of the levy of income tax. The concept of income in order to be of practical utility must be precise, clear cut, and also suitable from the administrative standpoint. Economists have from time to time come forward with definitions and economic analysis of the concept of income, but these are generally unsuitable for income-tax purposes. To take one instance, Professor Fisher defines income as a flow of services through a period of time.[1] Admirable as this definition is from the point of view of economic analysis, Professor Fisher himself admits that it lacks the definiteness which the legislator, the revenue authorities, the accountant and the judge must aim at, if the law of income tax is to be rightly formulated and interpreted.[2] A law of income tax based on Professor Fisher's definition ought to "pursue its victim to his dining-table and take toll from each mouthful, and should go with him to the theatre and tax every laugh." Practical considerations, therefore, demand a more definite and workable concept than any that might be

[1] See Fisher: *The Nature of Capital and Income* (1923), p. 52.
[2] Hewett: "The Concept of Income in Federal Taxation"—*Journal of Political Economy*, April, 1925.

suggested by theoretical economic analysis. Hence it is that persons upon whom have fallen the unenviable task of drafting the law of income tax have always avoided a direct encounter with theoretical issues. They have merely enumerated certain forms of receipts as taxable and have also mentioned certain other items which they have either excluded from the purview of the law or which they have authorized as deductions.[1] A few years ago Professor Felix Flügel made an examination of the income tax laws of various countries and came to the conclusion that in them " a definition of income is not to be found." [2] The Indian income tax law is no exception to this statement. Taxable income is divided into six classes: viz., income arising from (i) salaries, (ii) interest on securities, (iii) property, (iv) business, (v) professional earnings, and (vi) other sources. This evasion of the fundamental theoretical issue does not, however, mean that there is in the background no concept of income. For though income has nowhere been defined, yet there are at the back of statutory enumerations and administrative rules, certain notions which embody an idea that is fairly definite and precise for income-tax purposes. In trying to comprehend the Indian concept of income it will be useful to keep in mind the following questions:

(i) Is income taken to mean money income or real income and does it include income in kind?
(ii) Is income taken to mean gross or net income?
(iii) Is recurrence or periodicity essential to the concept of income?
(iv) Does income include accretions to capital assets?
(v) Are gifts and inheritances income?
(vi) Do savings form part of income?

Income in Kind.

Questions of a complicated character are raised by income in kind. The most common form of income in kind is the value of living quarters furnished rent free to an employee. The question arises

[1] Lutz: "The Treatment of Dividends in Income Taxation"—*Journal of Political Economy*, April, 1925.
[2] Plehn: "Income as Recurrent Consumable Receipts"—*American Economic Review*, March, 1924.

whether the value of rent-free quarters is to be added to a man's money income in order to determine his total taxable income. This question engaged the attention of the income tax authorities and the Indian Legislature during 1918–1923, but the decisions given on different occasions were not always logical and consistent. The question has now been definitely settled by the Legislature, which has declared in unequivocal terms that the right of a person to occupy free of rent as a place of residence any premises provided by his employer, should be regarded as a "perquisite" and hence taxable.[1] The Income Tax Act of 1918 contained a provision that any perquisite or benefit which was neither money nor reasonably capable of being converted into money should not be liable to income tax.[2] In spite of the existence of this provision in the statute book, towards the end of 1918 the Government of India issued instructions to the effect that the right to occupy rent-free quarters was a "perquisite" in an indirect sense. This perquisite was an addition to the remuneration of an employee and as such it was taxable, unless it was granted with the object of meeting the extra expense caused to an employee. Subsequently, the Government modified their former decision and gave out that where a person occupied rent-free quarters by virtue of his office and had a right to let them out, the annual value of such quarters should be taken into account in computing the total income, but where the individual had no such right it should be excluded.[3]

This last decision of the Government of India was quite in consonance with the English practice and with the verdict of the House of Lords in the well-known case of *Tenant vs. Smith*.[4] That case turned upon the liability of a bank manager, who was required to occupy the quarters given to him in the bank, to pay income tax on the money value of the quarters. The manager had no right to sublet

[1] *Income Tax Amendment Act*, Act XV of 1923.
[2] Section 3 (2) (ix), Act VII of 1918.
[3] *Vide Report of the Bengal Chamber of Commerce*, 1919.
[4] 1892. A.C. 150. See also an essay by Dr. W. A. Robson on Legal Conceptions of Capital and Income in the *London Essays in Economics* in honour of Edwin Cannan (1927), edited by Gregory and Dalton.

the quarters and was under an obligation to vacate the premises if he ceased to hold the post of the manager. The House of Lords held on these facts that the annual value of the premises occupied by the manager could not be brought into account in estimating his total income. Lord Halsbury remarked "the thing to be taxed is not income unless it can be turned into money." With a view to bring under taxation the value of rent-free residence, irrespective of the right of the occupier of such residence to sublet it, the particular provision in the Indian Income Tax Act of 1918 laying down that a benefit which was not money or capable of being converted into money was not liable to tax, was omitted from the new Income Tax Act of 1922. Although this was the avowed intention of the Legislature the matter was far from clear. For it is one of the accepted maxims of legal interpretation that a taxing statute should be interpreted on its actual words, without any reference to the intentions of those who framed it. The question of liability to taxation therefore turned, not on what the Legislature had intended by the omission of certain words, but on the question whether a rent-free house was a benefit, or perquisite, profit or gain or any other income of a kind specifically declared by the Legislature to be taxable. In 1923 the question was settled beyond all doubt by the Legislature which laid down that the right to occupy a rent-free residence was a perquisite within the meaning of the Income Tax Act of 1922.[1]

This decision is quite in consonance with economic theory. No faulty reasoning or injustice from the point of view of the accepted canons of taxation is involved in the Indian practice, for the right to occupy a rent-free residence is declared taxable under all circumstances, except in the cases of the Governor-General of India, the Commander-in-Chief, the Governor or the Chief Commissioner of a Province.[2] The exemption of these high officials is necessitated by political considerations and does not in reality constitute a violation of the general rule. The

[1] Section 2 of Act XV of 1923.
[2] See *I.T. Manual*, 1925, Vol. I, p. 87.

British practice on the matter is self-contradictory and is not capable of any rational explanation. In Great Britain the general law on the subject is that the annual value of living quarters given rent free to an employee is not considered taxable income. This rule is subject to an exception if the employee has the right to let out the residence to a third party. One can understand the necessity of this exception in view of the decision of the House of Lords in the case of *Tenant vs. Smith.* But it is difficult to reconcile this decision with the practice of the authorities in Great Britain to subject to income tax officers of the Crown who have to live in houses or apartments belonging to the Crown other than apartments in royal palaces.[1]

Psychic Income.

The problem of the taxation of what are known as "psychic incomes" is easily disposed of. In India as in Great Britain, income tax is payable in respect of the annual value of a house occupied by its owner. This is strictly in accordance with the faculty theory of taxation, for to exempt such income would be to discriminate in favour of one who chose to invest his capital in house-property as against another who preferred industrial investment, for instance. It might, however, be argued that by a parity of reasoning a tax should be imposed upon the psychic income enjoyed by a man from his investments in furniture, automobile, clothing, and pictures. But to this the answer is that a line must be drawn somewhere, and administrative expediency should decide which categories of intangible income should be brought under taxation. To ask the income-tax authorities to decide upon the money value of a satisfaction, when there is no standard available by which to decide it, is to ask for the impossible.

Income is, therefore, taken to mean money income with the exception of the items indicated above. But not all receipts and perquisites in the form of money are taxable. In the first place, such receipts must be income or profits

[1] *Vide* Spaulding: *The Income Tax in Great Britain and the U.S.A.*, p. 156; also Income Tax Act, 1918—Sch. A., No. VII, Rule 11; Konstam: *Law of Income Tax* (1926), p. 41.

or gains within the meaning of the Act. A gratuity paid, for instance, by railway companies or the Government to their servants or to the widows and children of their servants, if the employees are injured or killed in the execution of their duties, is not strictly speaking income, for it represents compensation for losses sustained.[1] In the second place, such money receipts are not taxable if they are specifically granted to meet expenses "wholly and necessarily incurred in the performance of a duty." Not only are business expenses deducted, but capital sums which are received in commutation of pensions, or which represent the proceeds of insurance endowments, gifts and inheritances in the form of lump-sum legacies, are exempt, since such sums do not represent additional income but capital.[2] Similarly all increments in the value of capital are exempted from taxation. If an individual purchases Indian War Loan, 1929–47, at 95 redeemable at par, he is not liable to income tax on the premium received on redemption. Again, if an individual purchases a house for his own residence, and later on sells it at a profit, he is not liable to taxation on the profit, for increase of capital as such is not taxable unless accompanied by an increase of income. As Plehn remarks:[3] "A fruit tree may grow ever so large in trunk and branches, but unless the new branches bear fruit, or are expected to do so, they are of no value."

Yet it often happens that capital is acquired and held for some time and then sold for the express purpose of obtaining and spending the increase in value. In such cases capital increments are used as income, and should be treated as such by the taxing authorities. The Indian income tax rules recognize the validity of this claim, for they lay down that if an individual makes a practice of speculating in the purchase and sale of shares, his profits from such transactions are liable to taxation.[4]

To the general rule that capital as such is exempt from

[1] In Great Britain these items are treated as casual profits and are not subject to income tax.
[2] *Vide* section 4, Act XI of 1922.
[3] *American Economic Review*, March, 1924.
[4] *Vide Income Tax Manual* (1925), Vol. I, pp. 91 and 104.

taxation, there is one exception which is, however, an apparent exception rather than a real one. Following the precedent set by British income-tax practice, terminable annuities are treated in their entirety as income, and no distinction is made between that portion which represents a refund of capital and that which represents income. From the early days of income tax in Great Britain annuities have always been treated like this, without regard to any question of capital involved. The matter was last considered in Great Britain by the Departmental Committee of 1905, which dissented from the view that annuities should be divided for income-tax purpose into two parts. They argued that a man who buys a life annuity deliberately sinks his capital and takes an income in exchange, and that the division of the income into capital and interest is a fiction. This fiction is based on actuarial data which have nothing to do with the particular circumstances of the case. Besides, they pointed out that as the existing annuities were created in Great Britain during the existence of the income tax, the contracting parties had taken the tax into consideration.[1] The situation in India is not materially different from that in Great Britain. Since the Income Tax Act of 1886 annuities have been treated as wholes, and it is possible to argue that no injustice is involved, as the parties to the contract have presumably settled their terms on the basis of the existing income tax.[2]

Taxation of Annuities.

Plehn has pointed out that for the purpose of income tax, income should be defined as " wealth available for recurrent consumption recurrently or periodically received." [3] He emphasized the significance of the element of continuity or of recurrence in the concept of income. This idea has also the approval of the analytical economists who conceive of income as a " flow " or

Taxation of Casual Gains.

[1] *Vide First Instalment of the Minutes of Evidence, Royal Commission on Income Tax*, Appendix 7 (*j*); compare also Cannan's *Wealth* (1928), p. 157.

[2] See section 7 of Act II of 1886, section 6 (1) of Act VII of 1918 and section 7 (1) of Act XI of 1922.

[3] *American Economic Review*, March, 1924.

"stream."[1] In accordance with this idea it is usual to exclude from the purview of income tax profits or gains of casual nature. If A wins a prize in a lottery the gain is not taxable, as it is only a casual receipt. This idea of excluding non-recurrent receipts is accepted in India with one modification of doubtful value. Casual gains which are the proceeds of profession, vocation or employment or which arise from business, that is, from "any adventure or concern in the nature of trade, commerce or manufacture" enjoy no immunity from taxation.[2] The Royal Commission on the Income Tax in Great Britain laid down that the scope of the British law should be extended so as to bring under taxation casual gains derived from business.[3] It is doubtful whether the proposed reform would be desirable from the administrative and financial standpoints. The main justification for the exemption of casual gains from taxation is the extreme difficulty of tracing isolated transactions and of preventing evasions. An income tax on casual gains tends to become voluntary contributions by honest and conscientious tax-payers. Compared with the relatively small net revenue which taxation of such income brings, it involves heavy administrative expenditure. It must also be borne in mind that if casual gains are brought under taxation, the Revenue should also make an allowance for losses on casual transactions. Under such circumstances, however, there is a strong tendency on the part of the assessees to record and claim deductions on account of losses, but there is no corresponding incentive to record casual profits. On a review of these considerations, it seems desirable to exempt from taxation all casual gains even though derived from profession, vocation or employment.[4]

[1] Compare Cannan (*Wealth*, Ed. 1928, p. 149): "The word 'income' does not suggest anything coming in casually once for all, but some continuous receipt which can be conceived as a rate per annum, although no doubt often at a fluctuating rate."

[2] Sections 2 (4), 4 (3) (vii) of Act XI of 1922.

[3] Report of the *Royal Commission on the Income Tax*, 1920, para. 91.

[4] Dr. Dalton argues (*vide Some Aspects of the Inequality of Incomes in Modern Communities*, pp. 162–71): "A regular income implies regular additions to the recipients' means of economic welfare, and an irregular income implies irregular additions, but both are equally income if we

Intimately bound up with the question of taxable income is the allied problem of exempted income. The income-tax authorities everywhere exempt certain classes of income from taxation, e.g., income of religious and charitable institutions, of institutions engaged in educational and philanthropic work, etc. The exemptions granted by the law and practice of income tax in India may be classified into three categories, viz., according as they are prompted by economic or political considerations or by those of public policy. The line of distinction thus suggested is not sharp enough to obtain a clear-cut tripartite division, but it will be convenient to examine the guiding considerations which have led to the grant of the existing exemptions in the order named.

The Exempted Income—

In a country which is handicapped due to lack of adequate capital, it is of the utmost importance to encourage savings as much as possible. It is this desire to encourage the growth of capital that accounts for the exemption from taxation, of the yield of post office cash certificates and the income derived from deposits in post office savings banks.[1] The same consideration [2] explains the remission from taxation granted to the co-operative societies in respect of the profits earned by them or in respect of the dividends or other payments made to members of such societies.[3] These societies were started in India under the patronage of the

are interested in the recipients' means of economic welfare." This inclusion of casual gains is perfectly legitimate when making an accurate comparison of the means of economic welfare available to different individuals. But from the point of view of income tax it seems desirable to exclude them, because of the administrative difficulty involved in taxing such receipts.

[1] Section 60, Act XI of 1922.

[2] Dr. Dalton remarks (*Public Finance*, p. 114) that the taxation of co-operative societies is objectionable from the point of view of distribution, since the majority of the members are comparatively poor. In India emphasis is perhaps laid on the side of production.

[3] This exemption applies to the profits of any co-operative society (other than the Sani Katta Salt Owners' Society in the Bombay Presidency) registered under the Indian Co-operative Societies Act, 1912, the Bombay Co-operative Societies Act, 1925, and the Burma Co-operative Societies Act, 1927, or the dividends or other payments received by the members of any such society on account of profits. See sections 25 (1) (*a*) of Act X of 1904, 28 (*a*) of Act II of 1912 and the *Income Tax Manual* (1925), Vol. 1, p. 87.

Government with the avowed object of encouraging thrift and self-help amongst agriculturists, artisans and persons of limited means, and the remission of income tax was one among several other privileges conferred on them by the Co-operative Societies Acts of 1904 and 1912. It is interesting to compare in this connection the tax-paying liability of the co-operative societies in Great Britain and in India. In India it appears that co-operative societies enjoy immunity from taxation only in respect of their profits. The interest which they derive from investments in securities or from bank deposits is taxable precisely in the same way as that belonging to joint stock companies. The privilege enjoyed by the British co-operative societies registered under the Industrial Provident Societies Act of 1893 is a wider one, for not only are their profits exempt from taxation, but also bank interest and dividend from investments.[1] These privileges, particularly those enjoyed by the retail distributive societies in respect of the exemption of their trading profits, aroused considerable resentment amongst private traders who urged the withdrawal of these concessions before the Royal Commission on the Income Tax. On a careful consideration of the nature of trading profits, the Commission recommended that any part of the net profits which were not actually returned as dividends on purchases should be charged to income tax.[2] They also recommended that reserves invested in stocks and shares should be subject to income tax. In short, they held that a co-operative society should be treated exactly as a limited liability company so far as taxation

[1] This statement applies to all co-operative societies registered under the Act of 1893, with the exception of those which have a limited number of shares and make a practice of selling to non-members. *Report of the Royal Commission on the Income Tax*, 1920, para. 544.

[2] *The Royal Commission on the Income Tax*, 1920, could not come to a unanimous finding on the question of the taxation of trading profits belonging to co-operative societies. The controversy turned on the principle of "mutuality." The majority Report accepted the view that a co-operative society was not merely a group of individuals, but a separate legal entity and that the net receipts left in the hands of the society after the refund of the dividends—on purchases constituted taxable profits independently of the way in which they had arisen. The minority took up the position that "the proceeds of mutual trade are not profits in any sense to the group of individuals among whom the mutual trade is carried on."

was concerned. This recommendation of the Commission was based on several important considerations. In the first place the rapid extension of the co-operative movement in England had given rise to keen competition between private traders on the one hand and co-operative retail distributive societies on the other. In the second place, the feeling of dissatisfaction among private traders had been aggravated by the high rate of income tax in recent years. In view of these considerations it is not difficult to justify their recommendation. But the circumstances in India to-day are totally different. The crying need in India is for more co-operative societies whether for credit, production, or for retail distribution. The question which India should consider is not whether their privileges should be curtailed, but whether they should be extended further. In 1924–25 there were in British India 62,894 co-operative societies of all description with a membership of 2,594,984 persons. The profit credited to reserve was Rs.38,226,688.[1] Obviously, under the existing law, the income from this profit in so far as it is reinvested is subject to taxation.[2] It may be seriously questioned whether it is good policy that this sum should be subjected to income tax, in view of the peculiar position which the co-operative societies occupy in the national economy of India.

Side by side with these exemptions, of which the main justification is the economic progress of the land, there are one or two minor ones of a political nature necessitated by inter-State courtesy. Thus the official allowances received by an agent of a Prince or of a Native State duly credited to represent his Prince or State in British India, or the fees and salaries received by foreign consuls and foreign employees from their own Government are exempt from taxation. On similar considerations, interest on Government securities held by ruling Chiefs and Princes of India in the special non-transferable form of Government Promissory Notes, is declared exempt.[3]

Income of Native Chiefs.

[1] *Statistical Abstract relating to British India*, 1915–16 to 1924–5.
[2] *Vide Income Tax Manual*, pp. 87 and 87*a*.
[3] Section 60, Act XI of 1922.

This immunity which the Native Chiefs of India enjoy has its parellel in Great Britain where income from British sources is not taxed to foreign Governments.[1]

The other exemptions recognized in India are those which have been prompted by considerations of public policy. Income derived from property held under a religious or charitable trust, income from voluntary contributions devoted to the same purpose and income devoted by Universities solely to educational work are not subject to income tax. By exempting income of this character, the State shows its appreciation in a visible form of the activities of these institutions. It is, however, well known that a considerable proportion of the income from property held under religious trusts in India is used in a manner not always conducive to social welfare. Too often the property is apt to be regarded as a personal possession by those administering the trusts, and the income diverted to purposes not sanctioned by the originator of the trust. The Government should consider whether the privilege of exemption from taxation should always continue irrespective of the particular circumstances of each case.

Income of Charitable, Educational, and Local Bodies.

The income of the "local bodies" from whatever source derived is also exempt. The "local bodies" are the creations of the State, their duty being to assist the State in a sphere in which it cannot usefully interfere, either because the work is of a character requiring minute supervision which the State is not competent to bestow, or because the work requires a knowledge of local conditions which the State does not possess. The expenses of the local bodies, which expression means in India a Municipal Committee, District Board, Port Commissioners, or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund, are met from funds raised by the levy of rates and taxes properly so called, or from trading activities of a miscellaneous though minor character. Great Britain and India have followed different policies, so far as the

[1] *Vide* Spaulding: *Income Tax in Great Britain and the U.S.A.*, p. 163.

taxation of the income of the local bodies is concerned. Under the English law the profits derived by the local authorities from their trading activities, from their ownership of tramways, gas, electric and water works are brought under taxation. But local bodies are not taxable on the proceeds of their rates.[1] In India, on the other hand, their entire income, from whatever source derived is immune from taxation.[2] This may at first sight appear to be a radical difference in the tax systems of the two countries. But on closer examination the difference disappears to a great extent; for municipal trading is yet in its infancy in India and, barring the three Presidency towns of Calcutta, Bombay and Madras, the extent of municipal trading is insignificant. In Bombay during 1925-6 the municipal budget estimated an income of a little over Rs.7,500,000 from municipal enterprise and municipal property, out of a total estimated revenue of Rs.34,096,950. In the other Presidency towns, revenue from municipal trading formed quite a small proportion of the total income.[3] The scope for the extension of municipal trading in India does not seem to be very large, as in 1921 there were only twenty-seven municipalities with a population of over 100,000 persons. In Great Britain the net profits derived from municipal trading in 778 towns amounted approximately to £8 millions in 1924.[4] In view of these facts no useful purpose will be served in India by following the lead of Great Britain. From the point of view of economic and political science also a fairly strong case can be made out for the continuation of the existing Indian practice. In the first place if the income from the trading activities of the municipal or local bodies be subjected to taxation, the taxes are ultimately paid by the rate-payers. Since local rates are proportional and not progressive, injustice is involved in this policy. In the second place where profits

[1] *Report of the Royal Commission on the Income Tax*, 1920, para. 529; Spaulding: *Income Tax in Great Britain and the U.S.A.*, p. 152.

[2] Section 4 (3) (iii), Act XI of 1922.

[3] See Shah and Bahadurji: *Constitution, Functions and Finance of Indian Municipalities*, p. 378.

[4] Shah and Bahadurji, *Ibid.*, p. 435.

are made by local bodies in the conduct of some public service, these profits are used for some purpose within their powers as public bodies. In the third place local bodies may be regarded as exercising a delegated power which in a less developed community is exercised by the State itself.[1]

In considering the subject of exempted income it is necessary to bear in mind a distinction drawn in India. There are certain items of income which enjoy an immunity from taxation in more than one sense. Not only are such items not subject to income tax, but they are not taken into account in determining the liability to taxation of an individual, or in determining the rate at which income tax should be levied on other sources of income. Under this class come such items as agricultural income, the yield of postal cash certificates, income from post office savings banks deposits, payments received by members of co-operative societies and a few other small items. These are excluded from consideration altogether. But such is not the case with regard to two other sources which are themselves tax free, but which are included in the total income in order to determine the liability of an assessee to income tax or the appropriate rate at which the tax is imposed. These are income derived from Government securities declared to be tax free by the Government, and income which is saved for the purpose of paying insurance premium on the life of an assessee.

Tax Exempt Securities.

During the last European War, India followed the lead of some of the belligerent countries in issuing war loans which were income-tax free.[2] The practice of issuing tax-free securities has been condemned by economists as being fundamentally inconsistent with the maintenance of a progressive income tax.[3] A

[1] *Vide Third Report of the Royal Commission on Taxation in Australia*, sections 450–63.

[2] The following securities were issued: Government of India War Bonds 1920, 1921, 1922, 1923, 1925, and 1928; 5 per cent. Loan 1945–55; 5 year 6 per cent. bonds 1926; 5 year 6 per cent. bonds 1927; 10 year 6 per cent. bonds 1930; 10 year 6 per cent. bonds 1931, 10 year 6 per cent. bonds 1932; 10 year 5 per cent. bonds 1933.

[3] See Lutz: *Public Finance* (1925) pp. 506–12; Seligman: *Studies in Public Finance*, Chap. VII; article by Hinrichs on "The Cost of Tax

tax exempt security destroys the efficiency of a progressive tax, in so far as the tax is intended to throw a heavier burden of public expenditure on those who are best able to bear it. Tax exemption is uneconomical from this point of view. It has also the effect of driving capital into the tax exempt securities. The result is an unjust discrimination against private industry which is compelled to pay a relatively high price for the capital required by it. The argument usually advanced in favour of tax exemption is that it enables the Government to borrow at a low rate of interest. But it is probable that the gain in the lower rate of interest is more than counterbalanced by the loss of revenue, particularly when steeply graduated taxes are imposed.

But while it is easy to condemn the Government on theoretical grounds, it is well to bear in mind that India erred in this respect in the company of other belligerent countries, U.S.A., for instance. Viewed as a war measure the policy of tax exemption succeeded in raising quickly the required sum of money. Then, again, it should be noted that the evils of tax exemption are minimized to a great extent in India, as the securities, although exempt from the ordinary income tax, are subject to the super-tax.[1]

Taxation of Savings.

The portion of the income which is spent in paying life insurance premium stands on the same footing as the income derived from tax-free securities. The exemption does not have the effect of reducing total income for the purpose of determining taxability or the appropriate rate chargeable. The limitations on this exemption are threefold. In the first place, abatement of taxation is authorized in respect of premiums paid by the assessee "to effect an insurance on his own life or on the life of his wife, or in respect of a contract for a deferred annuity on his own life or on the life of his wife." In the second place the abatement can be claimed in respect of premiums not exceeding one-sixth of the total income of

Exempt Securities" in the *Political Science Quarterly*, June, 1926. *Report of the Committee on National Debt and Taxation* (1927), Section II, pp. 56–9.

[1] See section 8 and section 58 (1) of Act XI of 1922.

the assessee. In the third place the allowance is not available for super-tax purposes.[1]

The concession in respect of savings in the form of life insurance premium was first introduced in India in 1886, and has been continued ever since. In Great Britain the principle of exemption was recognized in the first Income Tax Act of 1799, but was abandoned in 1842. It was revived by Mr. Gladstone in 1853 in order to mitigate the taxation of savings to a certain extent. In recent years in addition to the normal life insurance policy which secures a capital sum at death, other types of policies became common in Great Britain, namely those which were merely forms of investments rendered profitable by the rise in the rate of income tax. The result was that the Government were obliged to interfere in 1915 and 1916, with a view to stop the leakage of revenue which arose. The rules framed by the Government were directed against those types of policies which did not secure a capital sum at death.[2] Barring this particular feature of British income-tax administration, it is possible to maintain that the British and the Indian systems resemble each other in so far as one particular form of saving is singled out for favourable treatment. This feature, however, is not peculiar either to the British or to the Indian income tax, for it is generally recognized that income tax as ordinarily administered differentiates against savings in general (with the exception of life insurance premia), by striking savings when they are made, and again once more when they yield an income from investment.[3] To this extent there is a

[1] *Vide* section 15, Act XI of 1922.

[2] *Royal Commission on the Income Tax*, 1920, sections 291–3; Spaulding: *Income Tax in Great Britain and the U.S.A.*, p. 166.

[3] There is also another sense in which income tax as levied in Great Britain and in India is prejudicial to saving. The following observations of Mr. J. M. Keynes and Dr. Dalton before the *Colwyn Committee* will make this clear. Mr. Keynes remarked: "Income tax is especially deterrent to saving in so far as it falls on funds which naturally accumulate at compound interest and where no question of personal expenditure can enter in, e.g., the funds of insurance companies and the reserves retained by joint stock companies to provide further capital against an increase of their business. The latter is increasingly the way by which industry secures additional funds." Dr. Dalton said: "I suggest in particular the following reliefs . . . (*c*) a reduction in the rate of tax on

discrimination against the "saving use" as against the "spending use" of income. The most obvious way of removing this element of inequality and of exempting all forms of savings from taxation is to convert the income tax into a tax on expenditure.[1] It is apparent that the suggested course, however desirable from a theoretical standpoint, is impracticable on account of administrative and other difficulties. Nor is it possible to reform the existing system by extending to other forms of savings the concession which is enjoyed only by life insurance premium. It may be noted in this connection that the Government of India were obliged to reject a proposal which was made in 1918 to extend the privilege of exemption to all premia paid for effecting insurance for children's education. The possibilities of fraud and evasion are so great in a proposal of this character that it was felt administratively difficult to accept it. It is quite true that there is a loophole for fraud even with regard to life insurance policies, for the facilities which exist for borrowing on the security of these policies might be utilized by dishonest assessees for evading income tax. The protection of the Treasury, however, lies in human nature, for "there is an element of permanency in life insurance which is not possessed in equal degree by any other form of thrift." Thus it happens that only one form of saving is recognized for income-tax purposes. As the British Royal Commission on the Income Tax remarked:

> "If an allowance were extended to any other form of saving, it would be difficult to withhold it from all forms; but since methods of abstention from the consumption of income are infinite in variety, an allowance for all forms of saving would be quite impracticable." [2]

Having considered the nature of the income concept, it is now necessary to discuss the tests of liability to taxation in India. The income tax is levied on all income, profits

undistributed profits. . . . As regards (c), a genuine encouragement to saving would result, though care would need to be taken to prevent fraud through the formation of one-man companies, etc."

[1] Pigou: *A Study in Public Finance*, p. 139.

[2] Para. 297, *Royal Commission on the Income Tax*, 1920.

or gains (with certain specified exemptions already noted) "accruing or arising or received in British India." [1] The determining tests of liability to taxation are two in number, viz., (i) the origin of income within India, and (ii) receipt within India of income originating abroad.

Tests of Liability to Taxation.

The first principle is the more important and fundamental of the two, and explains by far the largest proportion of the receipts from income tax. According to this principle the tax is levied on all income accruing in British India, whether the recipient of income is resident in British India or not. If the profits and gains accrue within the county to any non-resident from any business connection, then the agent of the non-resident is chargeable with the tax, and is deemed to be an assessee in respect of the tax.[2] It is one thing to lay down a broad proposition of this character and a quite different thing to carry it out in actual practice. Rules have been framed with a view to assist the income-tax authorities in determining the profits which should be deemed to accrue in India, but these leave considerable discretion to the authorities, the exercise of which calls for judgment and tact on the part of the revenue authorities. The Income Tax Officer is given the power of determining the income of non-residents at a reasonable percentage of the turnover, or at an amount which bears the same proportion to the total profits as the receipts accruing in India bear to the total receipts of the business.[3] Where this method is unsuitable the profits may be fixed "in such other manner as the Income Tax Officer may deem suitable." The Indian Taxation Inquiry Committee came to the conclusion that it would be desirable to frame more definite rules as far as practicable. They suggested that income accruing to non-resident business men carrying on trading operations in India, through agents or branches, should be deemed to be neither greater nor less than that which was deemed to accrue to an Indian resident similarly

[1] Section 4 (1), Act XI of 1922.
[2] *Vide* section 42 (i), Act XI of 1922.
[3] *Vide* Rule 33 of the Board of Inland Revenue, Notification No. 3—I.T., dated the 1st April, 1922.

situated. The taxable profits of non-residents may be divided into two classes, viz., those accruing to a selling branch and those accruing to a buying branch. The profits arising from sale through agents of goods produced outside India should be ascertained "on the basis of the profits which might reasonably be expected to have been earned by a merchant, or where the goods are retailed by or on behalf of the manufacturer or producer, by a retailer of the goods sold who had bought from the manufacturer or producer direct." [1] With regard to a buying branch the Committee suggested that the proper method of ascertaining the profits made in India was to take the difference between the cost price of the goods bought in India and their market price f.o.b., less the expenses of getting them f.o.b. While these rules are eminently fair and reasonable they do not carry us very far in determining the exact taxable profit. They call for the exercise of the same discretion in the assessing authorities as the existing rules do. Even when these rules are interpreted in a reasonable manner difficulties are likely to arise in connection with the question whether certain profits or gains "accrue from any business connection in India." A company, for instance, may buy goods in India through agents and sell them abroad. Are the profits accruing from such sales effected outside India liable to Indian taxation? This very question was the subject of reference to the Calcutta High Court which has answered the question in the affirmative. The facts of the case were briefly these.[2] Rogers Pyatt Shellac Co. was incorporated in the U.S.A. and had its head-quarters in the city of New York. The company had a branch office in Calcutta to buy gum, shellac and other Indian products and a factory at Wyndhamgunj in the United Provinces. No sales were conducted in India. The goods were purchased partly on behalf of a Gramophone Company which paid the Rogers

[1] *Vide* Rule 12 of the English General Rules, Income Tax Act, 1918 (8 & 9 Geo. V, Ch. 40), also *Report of the Indian Taxation Inquiry Committee*, section 236.

[2] *Vide re Rogers Pyatt Shellac Company vs. The Secretary of State for India in Council—I. Income Tax Manual* (1925), Vol. II, p. 24.

Pyatt Company a fixed percentage on the purchase plus expense. The remainder of the goods was sold in the open market. It was held on these facts that the company was liable to pay income tax on the *whole* of the profits. The most important point to be noted in this connection is that the contract for sale was made not in India but abroad, and yet the whole of the profit arising from such sale was declared by the courts liable to taxation in India. The Taxation Inquiry Committee suggested that legislation would be necessary to nullify this decision. Early in 1928 the Government of India made an effort to put on a sound basis the method of taxing the profits arising out of purchases for export from India. But the attempt proved futile, as the Government and the commercial community could not come to an agreement on the subject.[1]

Taxation of Foreign Firms.

We have hitherto considered the liability to taxation of those profits which are earned in India by non-residents through the establishment of regular agencies. At times, however, non-resident companies derive substantial profits through their connection with Indian firms which are not technically agents or branches of such companies. By a suitable manipulation of accounts between the non-resident parent company and the subsidiary Indian company, it is possible to show that the Indian company is making very little or no profits at all. To bring such profits under taxation it is provided that where a non-resident in British India not being a British subject carries on business with a resident, income tax is chargeable to such non-resident in the name of the resident as if such a resident person were an agent of the former, if it appears to the Income Tax Officer that owing to the close control exercised by the non-resident over the resident, the course of business between these persons is so arranged that the business done by the resident in pursuance of his connection with the non-resident produces to the resident either no profits or less than ordinary profits which might

[1] Sir Basil Blackett observed as follows (*Indian Legislative Assembly*, 20th February, 1928): "We are not entirely contented with the existing section, but in the absence of considerable agreement as to the method of amending it we are prepared to try and work it further."

be expected to arise in the business. This provision of the Indian Income Tax Act is borrowed from the English law on the subject[1] and was first adopted in India in

Certain Special Cases.

The implications of the principle of origin of income have not been logically carried out in India, for certain categories of income, though accruing or arising in India, have been declared to be exempt from Indian taxation. Thus allowances, salaries or pensions accruing in India, but paid in sterling in the United Kingdom, or by means of a negotiable rupee draft in India, are exempt from Indian taxation. This order strikes us as anomalous when we find that salaries paid by the Government to their officers in the Native States of India are not similarly privileged.[3] If it is contended that the exemption from Indian taxation is one of the conditions of the employment of these officers it is far better that their salaries should be increased, rather than they should continue to be exempted "from considerations other than those of taxation."[4] As a matter of fact this contention regarding exemption has no validity, for the orders fixing salaries were passed long before income tax was first imposed. If it is once decided to subject such salaries to Indian taxation, the pensions of these officers also become automatically liable, for it is a universally recognized principle to regard pensions as deferred salary. The Taxation Inquiry Committee, however, held on what would appear to be insufficient grounds that with regard to pensions "the claims of domicile should prevail."[5] Now that the rules regarding the avoidance of double taxation within the British Empire have come into force, such incomes should be subject to Indian taxation in precisely the same way as any other income accruing in India. Of course the recipients of such income are in no way prejudiced by the proposed change, which affects only the

[1] *Vide* section 31 (3) of the Finance (No. 2) Act of 1915 and General Rules 7 of the English I.T. Act, 1918.

[2] *Vide* section 33 of Act VII of 1918; see *ante*, Chapter X.

[3] Section 7 (2), Act XI of 1922.

[4] *Vide Report of the India Taxation Inquiry Committee*, p. 192, and Memorandum by Dr. R. P. Paranjpye—p. 414 of the Report.

[5] Section 233 of *Report of the Indian Taxation Inquiry Committee*.

distribution of the proceeds between the British and Indian treasuries.

The income tax authorities in India have also taken it upon themselves to declare that salaries or allowances paid in the United Kingdom to employees of private firms or companies carrying on business operations in India should be exempted from Indian income tax, if the companies or firms are bound under a contract of agreement, or have agreed as a general measure, to pay such allowances in the United Kingdom.[1] This is an indefensible arrangement which allows two private individuals by the mere fact of their entering into an agreement to deprive a State of its undoubted right to tax all income originating within it.

The other categories of income accruing in India which are exempted from Indian income tax are the interest guaranteed to the railway companies by the Secretary of State for India, interest on the sterling securities of the Government of India, and interest on sterling securities issued by British companies carrying on business in India. The economic effect of these concessions depends on the fact whether capital which would not otherwise be invested in India is attracted or not. To the extent that this exemption increases the supply of loanable capital in India the effect is wholly beneficial. A predominantly borrower country like India has nothing to gain by the imposition of additional burdens on foreign investors.[2] But now that rules have been framed for the avoidance of double taxation within the British Empire, there is no reason why the Indian Treasury should continue to make a sacrifice of revenue. The interest on sterling loans, which is paid out of Indian revenues, should now be subject to Indian income tax.

While the principle of origin of income is the more important of the two tests which determine the liability to taxation, the other principle, viz., that of receipt within India, also finds a place, though a subordinate one, in the Indian tax system. Thus the profits and gains of business originat-

[1] *Income Tax Manual* (1925), Vol. I, p. 94.

[2] *Vide Report on Double Taxation* by Seligman, Stamp and Einaudi, also *Report of the Colwyn Committee*, para. 176.

ing outside British India are taxable if brought into India within three years of the end of the period in which they accrued.[1] This provision of the law was first inserted in the Act of 1922. There was no corresponding provision in the previous Income Tax Acts, with the result that such profits or gains were brought out to India at intervals, and a claim put forward that as such income was not received in British India in the year in which it arose, it was not income but capital.

The Position in Great Britain and in India Contrasted.

We are now in a position to compare and contrast the position in India with that in Great Britain, so far as the tests of liability to pay income tax are concerned. The position in India is fundamentally different from that adopted in most other countries, including Great Britain. In actual practice most Governments tax not only income originating in their territories, but also income accruing to their residents wherever it originates.[2] With a view to determine the liability of residents in respect of income from foreign possessions, stocks, shares, rents, and foreign securities, assessees in the United Kingdom are classified according to residence in three distinct divisions as follows :

(*a*) Persons ordinarily resident in the United Kingdom.
(*b*) Persons not domiciled in the United Kingdom, or if British subjects not ordinarily resident in the United Kingdom.
(*c*) Persons in the United Kingdom for some temporary purpose only, and not with any view or intent of establishing residence therein, and who have not actually resided in the United Kingdom at one time or several times for a period equal in the whole to six months in any year of assessment.

Thus if a person mentioned in class (*a*) above, i.e., a person ordinarily resident in the United Kingdom is engaged in the conduct of foreign business, he is taxed on the entire share of profits whether remitted to the United Kingdom

[1] Section 4 (2) of Act XI of 1922 as amended by the Income Tax (further Amendment) Act, 1923 (Act XXVII of 1923).

[2] *Vide* Pigou : *A Study in Public Finance*, p. 190 ; also an article by F. Allemes on " The Problem of Double Taxation "—*Economica*, June, 1926.

or not.[1] The principle which underlies the decision is that, as the assessee is ordinarily resident in the United Kingdom, his income from business is deemed to arise from trade carried on within the United Kingdom. The law of Indian income tax on the other hand does not seek to draw subtle distinctions between a person not ordinarily resident in the United Kingdom and one in the United Kingdom "for some temporary purpose only" with a view to determine his tax-paying liability, but it seeks to emphasize the fact whether income is actually received in British India or not. The liability to taxation turns not on residence but on actual receipt in India. Indeed, it has been decided by the courts that a person residing in British India but carrying on business by means of agents in various places outside British India is not liable to Indian income tax, if the income is not transmitted to him in British India.[2]

It is no doubt possible to adduce arguments for the adoption of the British system in India. It is possible to maintain on theoretical considerations that as the Government of India, as an integral part of the British Empire, protect the interest and property of Indian residents in other countries, the revenue authorities are justified in demanding a contribution from residents in respect of property situated abroad. Besides, taxation in proportion to ability does not admit of exclusion of incomes accruing abroad. But the strength of these theoretical arguments is attenuated by the very important practical consideration that Great Britain has a reason for taxing income originating abroad which India has not. Revenue derived from investment of British capital all over the world forms a very large source of income to Great Britain, and a great part of the British military and naval expenditure is incurred to protect these investments.

A comparative survey of the conditions under which income tax is administered in Great Britain and in India has revealed a few striking differences in the outlook of the

[1] Spaulding: *Income Tax in Great Britain and the U.S.A.*, p. 48.
[2] *Vide I.L.R.*, Vol. XLIII, *Madras*, p. 75—*Board of Rev. Madras vs. Ramanadhan Chetty.*

taxing authorities in the two countries. The most important of these differences, e.g., in the matter of taxation of the income of residents accruing from foreign sources, in the treatment of local bodies, in the curtailment of concessions in the case of certain type of life insurance policies in Great Britain, are capable of rational explanation in view of the variations in the local circumstances of the two countries. But the impression which one gathers from a study of the tax laws of the two countries is that the similarities are much more important than the differences. Whatever may have been the practice in the past, administrators in India at the present time look more and more to British experience for guidance when confronted with vexed problems of income-tax administration. It is significant that some of the provisions of the Income Tax Acts of 1918 and 1922 are borrowed verbatim from the English law on the subject. There is nothing unusual in this course. To the extent that the economic conditions in the two countries resemble each other, the experience and knowledge which one country has acquired as a result of years of working, is naturally utilized by the other.

CHAPTER XII

ALLOWANCES AND DEDUCTIONS

THIS chapter deals with the subject of allowances and deductions that are made in computing the tax-paying liability of the assessee. What the taxing authorities desire to assess is net income, i.e., gross income *minus* whatever expenses are incurred in earning that income. Theoretically speaking, the assessee's expenditure on food and clothing and shelter should be deducted to determine the net income. But it is a universally recognized practice to deduct only those items of expenditure " which are incurred in immediate and special connection with work or equipment from which income is derived." [1] The tax is payable in India by an individual, Hindu undivided family, company, firm and association of individuals. It will be convenient to study the respective deductions permissible in the case of each of these assessees in the order named above.

The Concept of Net Income.

At the outset we must draw a distinction between " total income " and assessable income. An individual's " total income " determines whether he is at all liable to the tax and, if so, the appropriate rate applicable to him.[2] [3] Assessable income is that part of the " total income " on which the rate as determined by the " total income " is applied. An individual's " total income " is computed with reference to his income from salaries, securities, property, business, professional earnings and other sources. All perquisites received by an employee in place of or in addition to salary

[1] Pigou: *A Study in Public Finance*, Part II, Chap. VII, p. 4.

[2] *Vide* sections 3, 15, 16, etc., of Act XI of 1922.

[3] The term " assessable income " is not used in the Act of 1922. Nevertheless a distinction exists in practice between " total income " and " assessable income."

or wages, all house-rent allowances, the value of rent-free quarters form part of the total income. In particular it is taken to include the following items:

(*a*) dividends received by him as a shareholder in a company, though such dividends may have been assessed to income tax in the hands of the company;
(*b*) the income from partnership, although this income may have been assessed to tax in the hands of the firm;
(*c*) insurance premia paid by him for insuring his own life or the life of his wife, or contributions compulsorily deducted under the authority of the Government for the purpose of securing a deferred annuity or for making provision for his wife and children, even though the premia and the contributions are themselves tax free;
(*d*) interest on securities declared to be tax free;
(*e*) interest on other securities.

In the case of those items from which income tax is deducted at the source, e.g., (*a*), (*b*) and (*e*), the amount of tax paid is added to the receipts for the purpose of computing the total income.

The total income of the assessee having been first determined, certain deductions are allowed with a view to determine the assessable income. The permissible deductions vary according to the source of the income. Thus where the income is derived from office, employment, profession or vocation, expenses wholly and necessarily incurred in the performance of the duties of an office or vocation as the case may be are allowed as deductions, care being taken to see that the items deducted are not in the nature of personal expenses. Money spent by the assessee for the maintenance of a motor-car or in employing a servant for travelling to and fro from his place of business is treated as personal expense, and hence no deduction is permissible on this account. Again, if the income is derived from securities and the assessee has obtained a loan from a bank for purchasing those securities, a set off is allowed in respect of the interest he has to pay against his total income, provided that the money was specially borrowed for the purpose of purchasing the securities.[1] In the case of income from

[1] *Vide Income Tax Manual* (1925), p. 95.

property consisting of any building used for residential purpose, the assessee is chargeable in respect of the *bona-fide* annual value thereof subject to certain deductions. The permissible deductions in respect of any property not devoted to business purpose are the following:

(*a*) sums paid on account of land revenue;

(*b*) sums paid to insure the property against damage, or where property is subject to mortgage, sums paid in respect of interest on such mortgage; also a sum equal to one-sixth of the annual value for repairs.

(*c*) a sum not exceeding 6 per cent. of the annual value for collection charges and a proportion of the annual value for vacancy, varying according to the period of vacancy, if any. It is obvious that where full allowance is claimed in respect of collection charges, the allowance for vacancies is cut down. Conversely, where full allowance is claimed for vacancy that for collection charges is reduced to nil.

The only limitation placed by statute on these deductions is that taken in the aggregate they should not exceed the annual value of the property in respect of which they are claimed. As the Act of 1922 allows losses under one head of income to be set off against gains under another, this limitation was inserted in order to prevent the annual value of property from being reduced to a negative quantity.

There are two questions of some practical importance which require to be discussed in this connection in order to realize the full significance of the deductions permitted by law. The question has been discussed from time to time in India whether municipal taxes or rates paid in respect of property, should be allowed as deduction for the purpose of the assessment of income tax, just as land revenue paid to the Government is so treated. It was urged, for instance, in 1922 in the Indian Legislative Assembly that municipal taxes should be deducted from the rent accruing from residential premises, and that the income tax should be assessed only on the balance.[1] The proposal was negatived mainly on the ground that municipal rates and taxes are generally in the nature

The Deduction of Municipal Taxes.

[1] See proceedings of the *Indian Legislative Assembly*, 25th January, 1922: Consideration of the *Report of the Select Committee on the I.T. Bill.*

of "beneficial" taxes, and as such they represent prices paid for benefits received from local bodies, e.g., supply of water, scavenging, etc. It is, however, noteworthy that in the case of business premises municipal rates and taxes, which are payable irrespective of whether profits are made or not, are allowed as deductions from business profits.[1] This may at first sight appear to be an anomaly which it is not possible to explain on any rational basis. But a moment's reflection will show that business premises stand altogether on a different footing from residential premises. In the case of business premises even if the deduction of rates and taxes be not specifically provided for by law, such items should in any case be treated as expenses wholly and necessarily incurred for the purpose of business. But it would be doing violence to the language of statute to regard municipal taxes as incurred solely for vocation or profession. At a meeting of the Bengal National Chamber of Commerce held in Calcutta in August, 1927, it was urged that municipal rates should be considered as a charge on the property, and as such should be deducted from income. As the Chamber put it, "in business such deduction is allowed in determining income tax. Why should not such deduction be allowed in the case of a landlord?" The answer to this query obviously is that such payments constitute personal expenses to the landlord, whereas they are business expenses to a firm.[2]

Deduction for Interest on Debts.

Another claim which is often put forward is that in estimating a man's income for the purpose of assessing income tax, the interest payable by him in respect of any debt should be deducted. It is contended that a man should be taxed according to his

[1] Section 2 (*b*) of Act III of 1928. See also the debates in the *Indian Legislative Assembly*, 20th February, 1928.

[2] It must be pointed out in this connection that for many years before the passing of the Act of 1922, it was the practice in some Provinces to allow the owner of residential properties to deduct from rent the amount of any municipal or other tax paid by him as owner (see *Burma Income Tax Manual*, 1905, Direction 25 and the Note). The view was taken that a municipal tax was a payment for advantages which increased the rent and should not be treated as income. It was regarded as a contribution which produced the rent out of which it was paid, and the net income was the rent after deduction of the tax.

ability and not in proportion to his liability. To take an illustration, if an assessee has an income of Rs.2,000 a year and is in debt in respect of which interest is payable amounting to Rs.3,000 a year, he should be exempted from taxation altogether, as he has no income but a recurring liability of Rs.1,000 a year. This contention, however, overlooks the whole basis on which income tax is generally assessed. Income is always taken to mean the surplus of receipts over expenditure incurred solely for the purpose of earning those receipts. In such a view of income no notice can be taken of how that income is spent. A part of the income may be spent to meet private expenses and the balance in anticipating the future income, and if a deduction were allowed in respect of this latter sum, it would be putting an undesirable premium on extravagance. A claim for deduction in respect of interest on debt in this unqualified form cannot be sustained either from the social or the economic point of view. When, however, the claim is put forward in respect of debts incurred for business purposes, it is regarded as a reasonable one and is universally admitted.

Marriage and Children Allowances.

The deductions and reliefs which we have hitherto considered are the only ones that are allowed to individuals in determining their assessable income. It will be noticed that the Indian system does not recognize the practice of giving abatement of income tax to assessees with or without children and dependants, or to bachelors who are under the necessity of employing housekeepers. In Great Britain the tax system is adjusted on the basis of the liabilities attaching to the family as a whole. It is possible to maintain that the view acted upon in that country is the only logical basis which it is at all possible to adopt in connection with income tax. Those who disregard the liabilities of the entire household fail to appreciate the true place of income tax in the tax system of a country. It is well known that expenditure taxes press with undue severity on the poorer sections of the community. These taxes fail to take note of the domestic circumstances of the tax-

payer, thereby disregarding the subjective basis of taxation.[1]

The Indian Taxation Inquiry Committee considered the question of the suitability of granting relief in India in respect of marriage or the maintenance of children and dependants, and came to the conclusion that no change was called for in the existing system. The considerations which weighed with the Committee in coming to this conclusion do not, however, carry conviction. The Committee argued that whereas the exemption limit for the purpose of the assessment of income tax was based on the cost of subsistence in most countries, in India, on the other hand, the existing limit had been placed at Rs.2,000 a year mainly on the ground of administrative convenience, and was much higher than that necessitated by the cost of subsistence in India. The Committee remarked that when the limit was raised to Rs.2,000 in 1919

> "one of the principal reasons . . . was the very large number of assessees falling within the lower range of income and the small sum realized by including them within the scope of the tax in relation to the trouble and expense involved in the assessment and collection of the duty." [2]

It therefore seemed right to the Committee "to set off the higher exemption limit against the absence of allowances in respect of dependants."

It is strange to find an argument of this character brought forward by a Committee which included a distinguished representative from the British Board of Inland Revenue. For whatever may be the considerations which fix the exemption limit in other countries, in Great Britain, at any rate, it has never been fixed deliberately and consciously on any consideration of the cost of subsistence, and yet this has not prevented the grant of allowance in respect of the domestic circumstances of the tax-payer. The British Royal Commission on the Income Tax, 1920, made the following

[1] *Reports from His Majesty's Representatives abroad respecting graduated Income Taxes in Foreign States*, Cd. 7100, 1913, p. 15; also Sir J. C. Stamp: *Fundamental Principles of Taxation*, pp. 17, 18.

[2] *Vide Report of the Indian Taxation Inquiry Committee*, p. 196.

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observations on the pre-war exemption limit in Great Britain :

" The truth is that the exemption limit has never in this country been based on a figure consciously related to any kind of minimum of subsistence, and that if our financial condition warranted it the exemption limit in 1914 might quite possibly have stood at £200 or £300 instead of £160."

With regard to the new exemption limit which the British Commission proposed they remarked as follows:

" While the limits we have suggested have not been arrived at *as merely representing the minimum of subsistence* for the persons to be maintained out of the income, we recognize that in some measure the cost of living has a practical connection with the possible taxable capacity." [1]

The truth is that in no country in the world is the exemption limit for income tax fixed on a mere consideration of the subsistence level. A number of considerations, economic, administrative and political combine to put the exemption limit at a figure different from that which a mere consideration of the cost of subsistence would warrant. In fixing the exemption limit regard is paid to the comparative weight of direct and indirect taxes upon various classes of communities. In every country the proportion of income spent by the poor upon the taxed necessaries of life is greater than that in the case of the rich. From the administrative standpoint regard must be had to the cost of collection of small amounts from a very large number of tax-payers. Again, regard must also be had to the proportion of public revenue directly given back to the tax-payers in the form of socially beneficial expenditure, e.g., old age pensions, sickness and insurance benefits.[2] Nor must we ignore the fact that the question of political franchise is intimately connected with the payment of direct taxes. The Indian Taxation Inquiry Committee disregarded these considerations, and declined to recommend the grant of marriage and family allowances on the ground that administrative

[1] *Vide Report of the Royal Commission on the Income Tax*, 1920, para. 247.
[2] See the author's evidence before the *Indian Taxation Inquiry Committee*, Vol. V, p. 260.

considerations had already fixed the existing exemption limit at an unduly high level. As a matter of fact we have it on the authority of the Indian Finance Member that the main consideration which weighed with the Government of India in raising the exemption limit to Rs.2,000 in 1919 was the post-war rise of prices and the resulting hardship. Referring to the rise of prices and its effect on persons with low salaries, the Finance Member observed in his speech introducing the Financial Statement for 1919–20 "on none has the present range of prices fallen more heavily than the people on low salaries, who are caught in the smallest mesh of our income-tax levy. There can be no question that Rs.1,000 minimum is now a serious hardship."

The Taxation Inquiry Committee further instituted a comparison between the exemption limit as it existed in India and that existing in Great Britain, and put forward the plea that the Indian limit was higher than that in Great Britain. The inference obviously is that no further relief is called for in India. But is the exemption limit really higher in India than in Great Britain? The answer to the question depends on whether we have in mind the British exemption limit for bachelors or for married men. In 1925–6 the effective exemption limits varied in Great Britain according to the circumstances indicated below: [1]

Single Persons.		Married Persons without Children.		Married Persons with 3 Children.	
All Investment Income.	All Earned Income.	Investment Income.	Earned Income.	Investment Income.	Earned Income.
£135	£162	£225	£270	£315	£378

It is clear from this table that the Indian exemption limit is higher than that fixed for a bachelor in Great Britain having an investment income, but it is not so with regard

[1] *Vide Report of the Colwyn Committee*, para. 338.

to married men with children; and it is the married men whom we must particularly consider, because as the Indian Taxation Inquiry Committee themselves pointed out, "the circumstances of the two countries differ in view of the fact that marriage is practically universal in India." [1] The conclusion which the Committee drew from this universal practice of marriage in India was that it was not possible to grant married persons relief, because bachelors who might be called upon to make good the loss of revenue were small in number. This consideration though relevant is not decisive, for the claim for relief is not simply confined to married men as against bachelors. Equity plainly demands that allowances should be made for the widely different ability to pay of persons with large families as against those with small families.[2]

The Committee were also of opinion that as there was no reliable and universal register of marriages, births and deaths, fraud and evasion were likely to be attempted, and that inquiries of an inquisitorial nature would have to be made in order to ascertain the true facts. It is quite true that fraud might be attempted in a few instances, but it is not likely to be widespread, for a local inquiry by an Income Tax Officer would immediately enable him to ascertain the true state of affairs. In any case, it is safe to predict that frauds in connection with marriage and children allowances would be easier to detect than dishonesty which is sometimes practised in the preparation of balance sheets or in the submission of returns of income. As regards inquisitorial inquiries regarding domestic circumstances, the assessee is not likely to resent them any more than the inquiries which are at present directed towards ascertaining his true income from all sources.

But the strongest criticism of the views of the Taxation Inquiry Committee on this point is to be found in the fact that two of their recommendations relevant to the subject are inconsistent with each other. The increase in the rates

[1] *Vide Report of the Indian Taxation Inquiry Committee*, p. 196.
[2] *Vide* Pigou: *Economics of Welfare*, Part IV, Chap. VI; also Pigou: *A Study in Public Finance*, Part II, Chap. VII

of income tax in recent years in India has led to the adoption of various forms of legal evasion, one of these being to execute a fictitious partnership deed, making a man's wife and children partners in a business. The result of this fraudulent arrangement is that each of the pseudo-partners becomes entitled to be taxed at a lower rate on his or her supposed share of income. For the purpose of the assessment of the super-tax also each of the supposed partners becomes entitled to a deduction of Rs.50,000. The obvious way of stopping this fraud on revenue is to lay down that the income of the wife should be added to that of the husband and the tax imposed on the aggregate thus arrived at. This is exactly what the Taxation Inquiry Committee have recommended. They remarked in this connection: "Apart from this reason, it is only just on general grounds that the incomes of married couples living together should be taxed at the rate applicable to the aggregate income."[1] If it is "just on general grounds" to argue that the income of the husband and wife should be treated as a unit, it is equally necessary to consider the liabilities attaching to the family income as a whole.

If the general principle as to the need for giving marriage and children allowances is admitted, the question of the determination of the exact amount of relief should not present insuperable difficulties. A modest beginning might be made by allowing a sum of Rs.200 a year for one lawfully wedded wife and a sum of Rs.100 each for children up to a maximum of three children. The right to claim relief should be circumscribed by laying down that the total income of the assessee from all sources should be less than Rs.3,000 a year, and that the children in respect of whom relief can be claimed, if they are above the age of 16, should be attending a recognized educational institution. Theoretically speaking the relief should not be limited to a particular income as the maximum as is here suggested, but should be extended along the entire scale of income from the highest to the lowest. But a compromise with theory is suggested on administrative and financial considerations. Even in

[1] *Vide Report of the Taxation Inquiry Committee*, para. 253.

Great Britain relief was originally confined to tax-payers with an income of not more than £800 a year,[1] and has since been extended to all incomes.

It will perhaps be objected that the grant of marriage and children allowances is likely to encourage marriage and the growth of population. This objection is superficial, and rests on the erroneous view that marriages are decided upon in India on a strict calculation of the economic resources of the individual. The relief proposed is too small to have any injurious reaction of the character apprehended. On the contrary, it is far more likely that a scheme of this kind will stimulate, it may be to a small though appreciable extent, the education of the young.

It is now necessary to make a rough calculation of the number of assessees who are likely to benefit from the scheme outlined above, and also to make an estimate of the probable loss of revenue. The Report of the Board of Inland Revenue for 1923–4 shows that the number of assessees receiving less than Rs.3,000 a year from salaries, professional earnings and from joint Hindu families was a little over 100,000 out of a total number of 283,883 assessees. It will be noticed that this number does not include persons who are in receipt of income from securities or from dividends. But the allowance to be made on this score is not likely to be very great, as some of the assessees who derive an income from securities and dividends have presumably other sources of income as well, e.g., those from salaried employments and professions. We may take it that the number of persons likely to claim this relief will not materially exceed 100,000. The consideration of the claims of these men when divided among twenty-three Provinces and circles into which India is divided for income tax work will not present insurmountable administrative difficulties.[2]

[1] *Vide Report of the Royal Commission on the Income Tax*, 1920, Part III, Section XI.

[2] The twenty-three Circles in 1923–4 were as follows: (1) Madras, (2) Bombay, (3) Bengal, (4) U.P., (5) the Punjab, (6) Burma, (7) Behar and Orissa, (8) C.P. and Berar, (9) Assam, (10) North Western Frontier Province, (11) Accountant-General Central Revenue, (12) Army Military Works, (13) Indo Posts and Telegraph Departments, (14) Indo-European

The loss of revenue resulting from the adoption of the scheme outlined above is likely to be small in amount, as will be evident from the following table which has been compiled from the Report of the Board of Revenue for 1923–4. It shows the collections of income tax (excluding super-tax) from salaried persons, joint Hindu families and professional men.

Grades of Income.	Tax Collected minus Refunds.	No. of Assessees.
Rs.	Rs.	Rs.
2,000–2,499	3,457,046	69,711
2,500–2,999	2,614,585	35,450
3,000–3,499	2,519,787	29,358
3,500–4,999	5,024,442	46,078
5,000–7,499	7,187,253	39,306
7,500–9,999	5,008,978	18,831
10,000–12,499	5,805,612	12,170
12,500–14,999	3,528,335	5,995
15,000–19,999	5,558,934	7,447
20,000–24,999	5,131,759	4,272
25,000–29,999	3,584,719	2,350
30,000–39,999	5,464,392	2,508
40,000–49,999	3,914,037	1,759
50,000 and over . . .	14,338,629	2,963
Unclassified	457,182	5,685
	73,595,690	283,883

It is clear that the adoption of the scheme of relief proposed in these pages will wipe out nearly the whole of the revenue derived from assessees within the grade of Rs.2,000–2,499. The revenue from persons in receipt of an income between Rs.2,500–2,999 will also be adversely affected, though it is not possible to say to what extent. In any case, the loss of revenue is not likely to exceed Rs.5,000,000. This is a small sacrifice to make if thereby we can remove

Telegraph Department, (15) Accountant-General Railways, (16) Rajputana Agency, (17) Ajmere Merwara, (18) Delhi Province, (19) Coorg, (20) Baluchistan, (21) Central Indian and Hyderabad Agency, (22) Civil and Military Station of Bangalore, (23) Audit Officer, Indian Stores Department.

one of the anomalies of the Indian income tax. The relief may be extended to income higher up the scale after the experiment has been tried for a number of years.

Allowances to Joint Hindu Families.

The allowances and reliefs permissible to a joint Hindu family proceed on much the same lines as those permissible to an individual with some little modifications. Before considering these modifications, it is necessary to explain the peculiar position of the joint Hindu family in the Indian legal system in general and the income-tax system in particular. The Hindus are in general governed by two different schools of law, viz., the *Dayabhaga* and the *Mitakshara* schools. Under the former school the father of the family is the absolute master of the property, the sons having no claim to partition the property or to alienate it during the lifetime of the father. This is the school which regulates succession practically in the whole of Bengal. In the rest of India the Hindus are governed by the *Mitakshara* school under which the right to property arises from the moment of birth. The moment a son is born he becomes a coparcener with his father, and can legally claim a partition with him. Under the *Dayabhaga* school the sons receive only maintenance during the lifetime of the father, and the income tax is collected from the father who cannot claim to deduct the sums spent for the maintenance of his sons, for these are personal and household expenses. On the death of the father the sons may partition the property, in which case the share of each individual member is liable to income tax, as the joint character of the family is broken up. If, however, the sons prefer to remain joint, the aggregate income is treated as a unit.[1] Under the *Mitakshara* school of Hindu law the family is treated as a unit, the taxing authorities not being concerned with the question of individual shares, unless of course the family is broken up by partition. The family, in fact, is regarded as an individual and taxed on a graduated scale according to its total income. When the Hindu undivided family is thus treated as a unit for the purpose of income tax, the income received by individuals as mem-

[1] *Vide* V. S. Sundaram: *The Law of Income Tax in India*, p. 120.

bers of such families cannot be taxed over again. This rule is necessary to prevent double taxation of the same income and is perfectly rational. But the law goes further than this, and lays down that such income should not be taken into account to determine the rate applicable to the individual income from other sources. The rule applies even if the total income of a joint Hindu family is less than Rs.2,000 a year, and as such is not taxable at all.[1] This feature constituted a radical departure from the law and practice existing under the Act of 1918 under which the share of the income of an individual member of a joint Hindu family was taken into account in determining the rate at which the assessee paid income tax on his other income.[2] The privilege was conferred in 1922 to offset the disadvantage resulting from the fact that a joint Hindu family was taxed more heavily than it would otherwise be if the members partitioned among themselves. When the family is treated as a unit, the premium paid to effect an insurance on the life of any male member or the wife of any such member of a joint Hindu family is exempted from taxation.[3] It is apparent from this rule that premium paid by a joint Hindu family to effect an insurance even on the life of a child is exempt from taxation. This concession is intended to cover cases of trading families in which boys of 10 or 15 years of age go in for joint family business.

Deductions to Business Concerns.

We now come to consider the deductions that are permissible in computing the profits of business. Generally speaking, the law in India follows that prevailing in England, section 10 of the Indian Income Tax Act being largely based on rules under Schedule D of the English Act. Before considering the deductions themselves, it is necessary to bear in mind that no complete list of permissible deductions is to be found in the Indian Income Tax Act, for the simple reason that the Act leaves a large amount of discretion to

[1] *Vide Income Tax Manual* (1925), Vol. I, p. 107; also sections 14, 16 of Act XI of 1922.

[2] See the statement by Sir Basil Blackett in the *Legislative Assembly*, 17th March, 1928.

[3] *Vide* section 15 (2), Act XI of 1922.

business men as regards the method of accounting they may care to adopt. Business men, for instance, are given the option of choosing either the cash basis or the basis of mercantile accountancy. Under the cash basis, in as much as a record is kept of the money actually received and of expenditure actually incurred, no allowance is permitted for bad debts. Under the system of mercantile accountancy, on the other hand, a deduction may have to be given for bad debts. But whatever the method of accounting adopted, there are certain deductions which are never allowed. It is a fundamental principle of income-tax law that no deduction may be made against profits in respect of capital outlay, just as accretions of capital should not, generally speaking, be added to gross receipts. Further, no company is allowed to deduct from its profits the interest on any capital that belongs to the shareholders or the owners of a business. But the interest on any capital that a company or a firm borrows from outside either by means of mortgages or by debentures is allowed to be deducted.[1] Lastly, no deduction is permitted in respect of expenditure which is in the nature of charity or presents, or expenditure which is not incurred solely for the purpose of earning the profits.

The following are the deductions that are permitted under the Indian income-tax law:

(*a*) an allowance for depreciation of plant, machinery, building and furniture at rates fixed by the Central Board of Revenue appointed by the Government of India;

(*b*) an allowance for obsolescence of any machinery or plant, a sum which is not the actual cost, but the original cost less the aggregate of allowances for depreciation and the sum actually realized by the sale of the obsolete plant and machinery;

(*c*) an allowance for current repairs and insurance against risk of damage to buildings, machinery and plant, the sum actually spent;

(*d*) rent paid for business premises and also any sum paid for land revenue, local rates or taxes in respect of such part of the business premises as is used for the purpose of business.[2]

[1] See *Income Tax Manual* (1925), Vol. I, p. 101.

[2] Local rates or taxes which are assessed on the basis of profits are not allowed as deductions—Section 2 (*b*) of Act III of 1928.

It will be evident from the above enumeration that the Indian income-tax law, like the law in Great Britain, recognizes the need for allowance in the case of "wasting assets" in order to prevent the taxation of capital. In this connection it is necessary to distinguish between three different kinds of allowances, viz., that (i) for depreciation, (ii) for obsolescence, and (iii) for depletion. Depreciation represents the decay in the plant, machinery and buildings due to physical wear and tear which cannot be made good by the allowance for current repairs. The allowance for obsolescence is granted when machinery or buildings become unsuitable for the purpose for which they were originally intended, owing to some new invention or changes in the condition of business. The term "depletion" is used to describe the process of physical exhaustion of Nature's supply of mineral or oil-bearing deposit or other resources limited in quantity.

Depreciation Allowance.

The allowances for depreciation vary with the nature of building or machinery and the occupation carried on. Thus for first-class substantial buildings of selected materials the allowance is fixed at 2½ per cent. on the prime cost. Higher rates are allowed for buildings used in industries which cause special deterioration, e.g., chemical or soap works and tanneries.[1] For rice, flour and bone mills the usual rate is 6¼ per cent.; for some kind of electrical machinery as much as 15 per cent. is allowed. The allowance for depreciation granted for any year can now be carried forward to subsequent years without any time limit if there are no profits in any year, or if the profit made is smaller than the allowance for depreciation.[2] This provision relating to the carrying forward of depreciation allowance was recognized for the first time in Great Britain in 1907 [3] and in India in 1918.

It would, however, be wrong to suppose that the law on the subject in India is exactly identical with that in Great Britain in every respect. For there are differences in detail

[1] *Vide Income Tax Manual* (1925), Vol. I, pp. 43–6.
[2] *Vide* section 10 (2) (vi) of Act XI of 1922.
[3] *Report of the Royal Commission on the Income Tax*, 1920, para. 209.

which often make the laws of one country more liberal to assessees than those of another. For instance, in India the allowance for depreciation in respect of buildings can be claimed by persons carrying on any "business," which expression means "any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce or manufacture."[1] The consequence of this liberal interpretation of the term "business" is that the allowance for depreciation for buildings is not confined as in Great Britain to those used for housing plant and machinery only, but can be claimed by traders in respect of their shops. It was urged before the Royal Commission in Great Britain in 1920 that all business premises, and even private houses, should receive an allowance in respect of gradual deterioration they suffered by reason of natural decay. The Commission, however, declined to extend the privilege on the ground that in deciding such question the probability of the simultaneous appreciation of the site on which the buildings stood, as also of the buildings themselves, could not be ignored.[2] They observed:

> "There are many houses in the neighbourhood in which we sit which have been in continuous occupation for 200 years and are to-day worth much more than they originally cost. Even where the original fabric has disappeared, either by decay or because it has suited the owner to rebuild the house for other uses, for example, as offices or business premises, the present value of the mere site is in many cases vastly greater than the cost of the site and building together when the house was first erected."

It is evident that these considerations apply with equal force in India, particularly in large industrial towns where there has taken place a phenomenal increase in land values in recent years. The advisability of confining depreciation allowance to buildings that are mainly used to house machinery and are therefore exposed to exceptional wear and tear caused by vibrations, should therefore be considered by the Government of India.

[1] *Vide* section 2 (4), Act XI of 1922.
[2] *Vide Report of Royal Commission on the Income Tax*, 1920, para. 221.

The allowance for obsolescence is granted in respect of plant and machinery when such plant and machinery are replaced. The amount allowed is the difference between the depreciated cost at the date of obsolescence and the sum actually realized for the asset when sold. Generally speaking, the Indian laws on this subject and those on depletion allowance closely follow the English practice.[1] When profits or gains accruing from such wasting assets as a coal-mine are taxed, strictly speaking from the point of view of economic theory an allowance should be made for the fact that the supply of coal in the mine is exhaustible. The tax would otherwise impinge on capital. If A and B have each a capital of Rs.10,000, and if A invests in 5 per cent. Government securities maturing in five years and B in a coal-mine which is estimated to yield a sum of Rs.2,500 a year for a period of five years, the positions of A and B, so far as capital and interest are concerned, are identical. But an anomaly will arise if B is taxed on his supposed annual yield of Rs.2,500 and A on his yield of Rs.500 a year. The fact is that the real income of B for income-tax purpose is considerably less than that represented by Rs.2,500, for this latter sum includes capital to the extent of Rs.2,000. The Royal Commission on the Income Tax in Great Britain were of opinion that income tax should have regard to the actual income earned by an individual during the income-tax year, rather than to the amount deduced from that income by a mathematical computation that must rely on very uncertain and variable data. They remarked :

Obsolescence and Depletion Allowances.

> " If the proprietor of a mine that produces an income of £5,000 is to be granted an allowance sufficient to enable him to replace his capital when the mine is exhausted, it would be inequitable to refuse an analogous allowance in respect of the initial capital invested in the education and training of a lawyer, or surveyor, or workman whose earning power is possibly of shorter duration than the life of the mine."

[1] It should be noted in this connection that obsolescence allowance is now granted in India in respect of animals used otherwise than as stock-in-trade when the animals die or become permanently useless—Section 2 (*a*), Act III of 1928.

There is some amount of truth in this contention, but at the same time it must be recognized that man is not merely an agent of production, as a steam engine or a coal-mine. Even if man is conceived merely as a wealth-acquiring machine, in Great Britain an allowance is already made for the human factor in production by means of reliefs granted to tax-payers with "earned"[1] income. There are, however, several difficulties in the way of granting depletion allowances in India. In the first place it must be recognized that considerable loss of revenue is likely to ensue from the extension of the allowance. In the second place, it is doubtful whether India possesses the administrative machinery and the technical knowledge necessary for the valuation of all the natural resources of the country. This last difficulty is, of course, not an insuperable one, particularly as the experience of the United States of America shows that it can be overcome. But if Great Britain with all her experience of income-tax administration has not yet found it practicable to attain theoretical perfection, there is no reason why the Government of India should go out of their way to give this concession. Besides, even from a theoretical standpoint much may be said in favour of the continuation of the existing Indian practice. Provided that the rate of the tax does not alter, an industry generally succeeds in dispersing the burden in course of time. It then obtains the current rate of remuneration. As Sir Josiah Stamp remarked: "Remedying the anomaly late in the day may possibly be little less than a present to the existing generation."[2]

There is one other allowance in respect of which business men in India have rightly demanded a change in the existing law and practice of income-tax assessment. This is with regard to the provision for carrying forward business losses in the computation of profits. Under the provisions of the existing Indian Act if an assessee sustains a loss in any year under any of the items of income, he is entitled

[1] *Vide* Spaulding: *The Income Tax in Great Britain and the United States*, p. 203.

[2] Stamp: *Fundamental Principles of Taxation* (1921), p. 140.

to have the loss set off against his profits or gains under any other head in that year. But he is not allowed to carry forward this loss to subsequent years.[1] In Great Britain, until very recent times, provision was made for carrying forward such losses under the system of averages. The period over which the average profit was calculated varied from three years in connection with trades and professions to seven years in regard to manorial dues.[2] Supposing the results of a man's business operations in 1924–5, 1925–6, 1926–7 were respectively a profit of £2,000, a loss of £3,000 and a gain of £4,000, he would be charged in 1927–8 on an estimated average income of £1,000 only. From the early days of income tax in Great Britain, the profits of a trader assessable under Schedule D have been computed on this basis. The Royal Commission on the Income Tax recommended the abolition of the average system under Schedule D, and the adoption of the previous year's income basis. In recommending this change the Commissioners were guided by two main considerations. In the first place, the change in the basis of liability would make the amount of profits assessed correspond more closely in point of time with the amount of profits actually earned. In the second place, it would be a very important step in the direction of uniformity and simplicity. While recommending this change, they suggested that with regard to losses, a set off for six years should be allowed. By the Finance Act of 1926, the basis of assessment was changed to the profits of the year immediately preceding the year of assessment. At the same time it was laid down that losses accruing from any business could be carried forward against the succeeding year or years' profits from the same business up to the sixth year of assessment following that in which the loss occurred.[3]

Allowance for Business Losses in India and Great Britain.

It is necessary at this stage to remember that it is not every country which is in a position to adopt a provision of this kind in the income-tax law. For the concession of

[1] *Vide* section 24 of Act XI of 1922.
[2] See Konstam: *The Law of Income Tax*, p. 7, supplement, 1927.
[3] *Vide* Finance Act, 1926, section 33 (1), (3), also Konstam: *The Law of Income Tax*, Supplement 1927, p. 24.

carrying forward losses for a fairly long period of time might create serious financial difficulty in the case of a country which depended for the bulk of its income tax upon the profits of some particular industry. Under such circumstances the country in question might be deprived of its revenue from income tax for a long period.[1] It is apparent that these considerations do not apply to Indian conditions, and there is no reason why business men should not be allowed to carry forward their losses. The Chambers of Commerce have from time to time impressed upon the Government the need for such a provision, but nothing tangible has resulted from these demands. The annual meeting of the Associated Chambers of Commerce of India and Ceylon passed the following resolution in January, 1922:

> " That this Association urges upon the Government the necessity of recognizing the equity of making provision for business loss when computing profits. The Royal Commission on Income Tax made full recognition of this principle, and the Association recommends that it should be made permissible for an assessee to carry forward losses for a period of three years." [2]

The Finance Department of the Government of India was unable to accept the proposal. When the income tax bill of 1922 was under discussion in the Legislative Assembly, the Bengal Chamber of Commerce put forward a very moderate proposal in this connection before the Government.[3] The Chamber suggested that in the year in which it was incurred, a business loss might be set off against a profit under another taxable head of income, but that any loss carried forward to the next or subsequent year for a period of three years should be allowed to be set off against the profits of the particular business from which the loss arose. It will be noticed that only the first part of this proposal was accepted in the Indian Income Tax Act of 1922, while no action has as yet been taken on the second

[1] *Vide Report of the Inter-Departmental Committee on Income Tax in the Colonies not possessing Responsible Government*, 1922, Cmd. 1788.

[2] *Vide Report of the Bengal Chamber of Commerce*, 1922.

[3] *Vide* evidence of Sir Alexander Murray and Mr. Kenneth Campbell before the *Indian Taxation Inquiry Committee*, Vol. V, pp. 337–8.

part of the recommendation, which related to the carrying forward of losses. The Indian Taxation Inquiry Committee recognized the justice of the claim, but they were of opinion that the concession should be hedged round with restrictions. They proposed that a loss sustained in any one year should be allowed to be set off against the profits in the next subsequent year only, subject to the condition that an assessee who claimed to have made a loss must prove it by the production of his accounts as soon as possible after the close of the year in which the loss was made.[1] The State is generally recognized as a partner in the prosperity of its subjects. Such partnership, however, should carry with it corresponding responsibilities. The existing arrangement is extremely one-sided. Well may the business men say that the Government are acting upon the principle of "Heads you win, tails I lose."

Special Treatment of Life Insurance Companies.

We have hitherto considered the profits of businesses and the deductions that are permissible for estimating such profits. There is, however, one class of business in respect of which the ordinary method of estimating profits is inapplicable. These are life insurance companies. It is evident that many of the items of expenditure of a life insurance company are uncertain, because the liability attaching to a company may arise at any time. The receipts, on the other hand, are certain and continuous, as the premiums are usually distributed throughout the year. Again, a newly started company will have a large amount of premiums, but will have few or no claims to meet. Under these circumstances the application of the orthodox method of estimating profits will lead to glaring inequalities. The valuation of the profits of life insurance companies is a mathematical process of great complexity, and not a mere balancing of receipts against expenditure.[2]

In India the profits of life assurance companies incorporated within the country are ascertained by taking their

[1] *Vide Report of the Indian Taxation Inquiry Committee*, p. 191.
[2] See evidence of Messrs. Hovil, Law and Macnaghten before the *Royal Commission on the Income Tax*, 10th October, 1919, Commd. 288–5.

annual average profits as disclosed by the last actuarial valuation. To the profits thus ascertained are added all items deducted in arriving at the actuarial valuation which are not permissible under the Indian Income Tax Act.[1] If, however, income tax deducted at the source on investments exceeds the tax on profits actuarially determined a refund is granted. Insurance companies registered abroad, but carrying on business in India are taxed differently. In the absence of a more reliable data, their Indian profits are deemed to bear the same ratio to their total profits as their Indian premium income bears to their total premium income. In Great Britain life insurance companies are taxed either on interest less expenses of management, or on the basis of profits ascertained by quinquennial actuarial valuation. In the case of a large majority of life offices, as the interest basis of taxation yields greater revenue than the actuarial valuation basis, the Board of Inland Revenue naturally chooses the first.[2]

As between the Indian method of taxation which is the actuarial basis and the British method which is the interest basis, the latter is to be preferred on account of its simplicity. The actuarial basis of taxation has an air of plausibility and accuracy which it does not in fact always possess. The profits of life insurance business depend upon a variety of factors, e.g., the mortality tables used, the standard of medical examination adopted, the premiums charged, etc. These are not uniform amongst competing life insurance business. The profits calculated on an actuarial basis bear no necessary relation to the actual profit earned.[3]

[1] *Vide* Rules 25–26, *I.T. Manual* (1925), Vol. I, p. 67.

[2] *Vide* evidence of Hovil, *Royal Commission on the Income Tax* (288–5), p. 827.

[3] The reader is referred to Spaulding: *The Income Tax in Great Britain and the United States*, Chap. VII, for a more detailed account of the respective advantages of the different methods of taxing insurance companies.

CHAPTER XIII

THE ASSESSMENT AND COLLECTION OF THE TAX

The Assessment of Income Tax.

THE Indian income tax is divided into two parts, viz., the ordinary tax and the super-tax. The ordinary tax is levied on all incomes of Rs.2,000 a year or more. Incomes are divided into classes by reference to their amount, and graduated rates are charged according to the range within which a particular income falls. The classification of income and the rates are given below:

INCOME.				RATES.	
Less than Rs.2,000				Nil.	
Rs.2,000 or upwards but less than			Rs.5,000	5	pies in the rupee.
5,000	do.	do.	10,000	6	do.
10,000	do.	do.	20,000	9	do.
20,000	do.	do.	30,000	12	do.
30,000	do.	do.	40,000	15	do.
40,000 or upwards	.	.	.	18	do.

These graduated rates are applicable to (*a*) individuals, (*b*) joint Hindu families, and (*c*) unregistered firms. The Indian income tax law draws a distinction between the rights and privileges of a registered firm and those of an unregistered firm. A registered firm is a firm constituted under an instrument specifying the individual shares of the partners, of which the prescribed particulars have been registered by the Income Tax Officer. Any partnership not complying with the above regulation is regarded as an unregistered firm.[1] This distinction between two kinds of partnerships has given rise to differences as regard their status for the purpose of the assessment of income tax and super-tax. Registered partnerships are assessed to income tax at the maximum rate whatever their income may be.

[1] Section 2 (14) and (16) of Act XI of 1922.

A partner of the firm has, however, the right to apply for a refund in case this maximum rate is inapplicable to his total income, which, of course, includes the income from partnership. An unregistered firm, on the other hand, is treated as an individual, and pays income tax at graduated rates specified above only if the total income of the partnership is Rs.2,000 or more. A member of an unregistered firm cannot under any circumstance apply for a refund of the tax, but as in the case of the registered firm the share of the individual partner in the profits of the firm is included in his total income for the purpose of determining the rate at which he should pay income tax on any other income.[1]

The companies in India, like registered firms, are taxed at the highest rate. While apparently the companies pay the income tax on their earnings, they in reality act as agents on behalf of the shareholders; because when dividends are distributed the companies deduct and retain the tax. The shareholder in his turn applies for a refund, if owing to his income being less than the minimum taxable income he is not subject to tax at all or is subject to a rate less than the maximum.

The Assessment of Super-tax.

The super-tax is imposed on all incomes in excess of Rs.50,000 a year, except in the case of joint Hindu families, who are exempt to the extent of Rs.75,000 a year. The super-tax is payable by (i) individuals, (ii) joint Hindu families, and (iii) unregistered firms. The rates in force are given below:

Income.				Rate.
Over	Rs.50,000 a year	and up to	Rs.100,000	1 anna in the rupee
,,	100,000	do.	150,000	$1\frac{1}{2}$ annas
,,	150,000	do.	200,000	2 do.
,,	200,000	do.	250,000	$2\frac{1}{2}$ do.
,,	250,000	do.	300,000	3 do.
,,	300,000	do.	350,000	$3\frac{1}{2}$ do.
,,	350,000	do.	400,000	4 do.
,,	400,000	do.	450,000	$4\frac{1}{2}$ do.
,,	450,000	do.	500,000	5 do.
,,	500,000	do.	550,000	$5\frac{1}{2}$ do.
,,	550,000	. . . . .		6 do.

[1] *Vide Income Tax Manual* (1925), Vol. I, p. 80.

These graduated rates are applicable not to the whole of an income, but to sections or slices lying between the limits indicated. Registered firms as such are not subject to super-tax, the share of the individual in the profits of such firms being included in the income of each partner for the purpose of super-tax. Where an unregistered firm is not assessable to super-tax owing to profits being less than Rs.50,000, the share of the individual in the profits of such firm is included in the return of the total income of the partner.

The Indian Company Super-tax and the British Corporation Profits Duty.

The Indian company super-tax is levied at the flat rate of 1 anna in the rupee on all profits in excess of Rs.50,000 a year. The company super-tax, as has already been pointed out in a previous chapter, is in the nature of a corporation profits tax. No refund is therefore allowed to shareholders in respect of this tax. The position of the Indian companies with regard to super-tax is fundamentally different from that in Great Britain. In the latter country a corporation as such is not at present treated as an entity for the purpose of either income tax [1] or super-tax. The underlying idea in Great Britain is that income tax or super-tax is to be regarded as a tax on individuals levied in accordance with their taxable capacities. It is quite true that there was in existence in Great Britain from 1920 to 1924 a separate tax on companies known by the name of corporation profits duty, in addition to the ordinary income tax. But with the abolition of the duty in July, 1924, the separate taxation of companies ceased.

The question of the abolition of the Indian company super-tax came up for consideration before the Taxation Inquiry Committee. The Committee recommended the retention of the existing tax, with this modification that the

[1] It is true that both in Great Britain and in India the undistributed profits of a company are subject to the maximum rate of income tax. But the reason for this is, not that the company as such is liable to tax, but that the shareholders to whom the undistributed profits ultimately belong cannot be separately taxed in respect of such profits at rates appropriate to the income of each shareholder. (The *Report of the Royal Commission on the Income Tax*, 1920, p. 164.)

exemption limit of Rs.50,000 should be abolished [1] and the entire profits of companies subjected to the flat 1 anna rate. The recommendation for the retention of the company super-tax was based on two main considerations. In the first place the advantages of limited liability and transfer ability of shares, which incorporation gives to a company, have more value in an undeveloped country like India than in Great Britain. In the second place, in Great Britain the undistributed profits of companies which ordinarily escape super-tax are, under certain conditions, taxed at the discretion of the revenue authorities. The abolition of the company super-tax in India without such a device for the taxation of undistributed profits would mean that they would cease to be taxed altogether. We shall see later on in the section dealing with evasion that the Taxation Inquiry Committee have recommended that undistributed profits of companies should, under certain conditions, be brought under taxation in India as in Great Britain. In the event of such a recommendation being carried out, the justification for the retention of the company super-tax might appear much less than at present. But as the tax on companies is responsible for more than half the total receipts from super-tax (as the table given in Appendix F clearly shows), its retention is at present suggested by financial considerations. The theoretical justification for a corporation profits tax also points to the same conclusion.

The Method of Effecting Graduation.

The foregoing analysis shows the manner in which income tax and super-tax are assessed. It will be noticed that the method by which graduation is effected in the ordinary tax is different from that employed in the case of super-tax. In the first case the rates specified in the graduated scale are applied to the

[1] In recommending the abolition of the Rs.50,000 exemption limit, the *Indian Taxation Inquiry Committee* pointed out that small companies derived relatively as much advantage as large ones from the privilege of incorporation. Apart from this theoretical objection, it should be noted that the effect of the exemption limit is to establish a graduated, or more accurately a degressive, tax on company profits. The result is that an investor having a small share of, say, one hundred rupees in a company with large capital pays tax at a higher rate than a similar investor in a company with a smaller capital.

whole of the income. For the assessment of super-tax on the other hand, the various rates in the scale are applied not to the whole income, but to section or slice of income lying between specified limits. The method applied to ordinary income tax, while it no doubt secures a fair measure of graduation when the system is viewed as a whole, is defective in as much as the rate advances suddenly at certain points. It involves substantial "jumps" in the amount of tax payable, at the passage from one step in the scale to another, with the result that it gives rise to a great anomaly. The nature of this anomaly is best seen by taking an example. Under the existing law a man with an income of Rs.1,999 is not liable to pay any tax at all. But the moment his income increases by 1 rupee, he is taxable on his entire income at the rate of 5 pies in the rupee. The result is that a man with an income of Rs.2,000 is reduced to an income of approximately Rs.1,948, and is therefore worse off than one with an income of Rs.1,999. Such a position, of course, would be intolerable, and the Legislature has already provided for it under section 17 of Act XI of 1922, which runs as follows:

> "Where owing to the fact that the total income of any assessee has reached or exceeded a certain limit he is liable to pay income tax or to pay income tax at a higher rate, the amount of income tax payable by him shall, where necessary, be reduced so as not to exceed the aggregate of the following amounts, namely:
> (*a*) the amount which would have been payable if his total income had been a sum less by 1 rupee than the limit, and
> (*b*) the amount by which his total income exceeds that sum."

This remedy, however, is not at all complete. For an assessee will find it to his interest to take advantage of the provisions of section 17 only if his income is slightly in excess of the fixed grade. A man with an income of Rs.2,053 would much rather pay the tax on his income at the rate of 5 pies in the rupee than take advantage of section 17.[1] But if he chooses the first alternative he is reduced to the

[1] If he takes advantage of section 17 he has to pay Rs.54. On the contrary if he chooses to pay in the ordinary way, he becomes liable to the extent of Rs.53—7 annas and 5 pies only.

position of one earning a little over Rs.1,999. In other words, he does not acquire any increased spending power by the increase of his income. Similar anomalies occur at all points in the scale where the rate of the tax increases. A system like this is theoretically indefensible and gives rise to hardships.

It is interesting to note in this connection that the British income tax suffered from a similar defect prior to the acceptance during 1920–1 of the recommendations of the Royal Commission on the Income Tax.[1] Until that year the tax was chargeable on the whole income when it exceeded a stated amount. The Royal Commission characterized the effect of the system as anomalous, and under the existing method of graduation hardships of this kind have been avoided.

The Taxation Inquiry Committee admitted that the Indian system was defective, but declined to recommend any change on the ground that it was essential above everything else to secure a satisfactory system of working and not to make changes in the machinery without very solid grounds.[2] In this connection it is necessary to emphasize the fact that the existing Indian rates are considerably higher than those levied during the war. It is therefore of the utmost importance to avoid injurious reactions of the character described above, for the evils of the existing system of graduation are exaggerated when the rates are high. The remedy is to allow an abatement and to apply graduated rates to sections or slices of income lying between different grades. The Central Board of Revenue prepared a scheme on the above lines and submitted it before the Taxation Committee. It was rejected on the ground that it would complicate the tax and multiply the number of claims to repayments. But the way to deal with administrative difficulties of this kind is to strengthen the staff, and not to perpetuate a system admittedly defective.

As regards the adequacy or otherwise of the existing

[1] Report, Part II, Section II, paras. 131–9; also *64th Report of the Commissioners of H.M.'s Inland Revenue* (Comd. 1436) for the year ending 31st March, 1921, p. 80.

[2] *Report of the Indian Taxation Inquiry Committee*, p. 198.

rates, it is well to bear in mind that the scale of graduation which is equitable cannot be determined until account has been taken of all the constituent elements of the tax system. In fixing the rate of income tax applicable to smaller incomes one must take note of the numerous indirect taxes, e.g., those levied on imported cotton textiles, salt, sugar, matches, etc. For larger incomes attention must be paid to the fact that there is as yet no developed system of death duties in India. This last consideration points to the necessity of stiffening up the existing rates of income tax, in view of the fact that higher incomes are not paying anything like their proper share. The following table [1] shows the proportion of income contributed in income tax and super-tax in Great Britain and in India in 1924 :

The Adequacy of the Rates.

Income in Sterling.	[2] Per cent. of Income taken in Income Tax and Super-Tax.	
	Great Britain.	India.
50	—	—
100	—	—
135	—	2·6
150	—	2·6
300	—	2·6
500	3·3	3·1
1,000	10·8	4·7
2,000	17·0	7·8
5,000	28·0	11·5
10,000	38·0	14·6
50,000	50·0	32·9
100,000	52·0	39·9

This table brings out that the contribution made by incomes between £1,000 and £10,000 are decidedly low in India as judged by the standard in Great Britain. It is

[1] *Report of the Indian Taxation Inquiry Committee*, p. 199.
[2] For estimating the tax payable in Great Britain the tax-payer is assumed to be married and to have three children.

true that in recent years there has taken place a reduction in the rates of taxation in Great Britain. The Colwyn Committee on National Debt and Taxation (1927) estimated that the pressure of direct taxation (including income tax, super-tax, inhabited house duty and death duty) on an earned income of £1,000 amounted to 8·1 per cent. in 1925–6, while the pressure similarly calculated on an income of £50,000 amounted to 44·2 per cent.[1] But even after these reductions, the disparity in the proportion of income taken by direct taxes in the two countries is sufficiently large to attract attention.

The Taxation Inquiry Committee have suggested an increase in the scale of duties from Rs.15,000 upwards. The Committee's recommendations together with the existing scale of duties applicable to Rs.15,000 upwards are given in the table below:

INCOME.		Existing Rate.	Recommendation of the T.I.C.
Where the Income is	But is Less than		
Rs.	Rs.	Pies in the Rupee.	Pies in the Rupee.
15,000 . .	20,000	9	12
20,000 . .	25,000	12	15
25,000 . .	30,000	12	15
30,000 . .	40,000	15	18
40,000 up .	—	18	18

With regard to super-tax they have suggested that the payment of the tax should begin with an income of Rs.30,000 instead of Rs.50,000. They also recommended that the limits of exemption applicable to joint Hindu families should be reduced from Rs.75,000 to Rs.60,000. These recommendations are very moderate and, in view of the financial situation as disclosed in the budget for 1929–30,[2] the rates

[1] *Report of the Committee on National Debt and Taxation*, pp. 94–5.

[2] The year 1928–9 virtually closed with a deficit of Rs.7,500,000. The budget for 1929–30 was balanced by drawing Rs.9,000,000 from

should suitably be increased in the higher reaches of income as well. No apprehension need be entertained from this increase of taxation, as regards injurious economic consequences from the point of view of productive effort. Recent investigations undertaken in Great Britain by the Colwyn Committee have shown that the comparatively high post-war taxation had little or no effect in repressing enterprise.[1] It is now admitted that for the bulk of income-receivers in normal times the demand for income has very little elasticity, although, as Dr. Dalton remarks, "it may well be more elastic in times of depression than in times of boom, and more elastic among the inefficient than among the efficient." [2]

A few words may be said in connection with the problem of differentiation. It will be noticed that the Indian income-tax law does not recognize the distinction which is very prominent in Great Britain, namely, that between earned and investment income. This distinction is a comparatively recent development in British income tax. Ever since the introduction of the first income tax in Great Britain in 1798, the demand for differentiation in favour of income derived from personal exertion was carried on with great persistence throughout the whole of the nineteenth century. But it was not till the Select Committee of 1906 had reported in favour of the scheme that it was incorporated for the first time in the Finance Act of 1907. At the present day earned income is diminished by one-sixth for the purpose of assessment, the allowance being limited to a maximum of £250, while investment income is charged at its full value. The circumstances of India are so totally different that it would be undesirable to incorporate this feature in the tax system. At the present day agricultural rents are exempt from taxation. It would therefore be inequitable to single out other forms

Differentiation.

the Revenue Reserve Fund. This Fund was expected to stand at Rs.10,400,000 on the 31st March, 1929. See *Financial Statement for* 1929–30.

[1] *Report of the Colwyn Committee*, Sections 423–34. See also an article by Keynes in the *Economic Journal*, June, 1927.

[2] Dalton: *Public Finance*, p. 86.

of investment income for taxation. Even if agricultural incomes were brought under taxation in future, the necessity of hastening industrial development in a predominantly agricultural country like India would suggest that investment income derived from industry should not be discriminated against.[1]

Stoppage at Source and Refunds.

The Indian income tax, like the British income tax, takes recourse to the device of collection at the source to a very large extent. It has been estimated that in Great Britain at least 70 per cent. of the total yield of the tax is collected at the point where the income emerges.[2] The percentage of such collection in India is not so great. But no conclusion adverse to the Indian income-tax administration should be deduced from this fact taken by itself, as the percentage depends upon the constituent elements of national income. If income from securities and from companies form a preponderatingly large proportion of national income, it is evident that a larger amount of national income will be collected at the source than if the national income were derived mainly from professional earnings or from trading operations carried on by individuals.

In India the tax on the income from securities, on the profits of companies and that payable by registered firms is collected at the source. As far as practicable, the income tax on salaries is similarly collected. But statistics are not available to show precisely to what extent the tax on salaries is collected in this manner. Out of a total collection of ordinary income tax, nearly amounting to Rs.1·20,000,000 during 1925–6, a sum of Rs.40,000,000 was realized by taxation at the source from securities, companies and registered firms. In addition, a good portion of the sum of Rs.25,000,000, which represented the collection from salaries, must have been realized by deduction at the source.

In the case of company dividends, income from partner-

[1] The *Taxation Inquiry Committee* remarked that if at any time agricultural incomes were brought under income investment incomes should also be taxed. It seems that the Committee have underestimated the need for the rapid industrialization of India.

[2] *Report of the Royal Commission on the Income Tax*, 1920, para. 154.

ships and securities, the tax is collected at the maximum rate, as persons paying such incomes have no information regarding the total income of the recipients. Provision is accordingly made for refund, if any, in any case the income of the assessee is such as to entitle him to such refund.[1] It has already been pointed out that there are certain incomes which are altogether exempt from taxation, e.g., income enjoyed by charitable and religious trusts, local authorities, and that accruing from securities held by approved Provident Funds. In order to reduce the number of applications for refunds in the case of income from securities held by these institutions, the Income Tax Officer is empowered to issue certificates authorizing persons paying interests to make no deduction at all, or to deduct the tax at a rate lower than the maximum. Such certificates remain in force until they are cancelled and are not required to be renewed annually. During 1923–4 the Government of India decided to extend the concession to all classes of securities, including those issued by local authorities or by companies. As regards refund such securities have therefore been placed on the same footing as Government Promissory Notes.[2] An individual owner of securities whose total income from all sources is less than Rs.2,000, or whose income is not liable to marked fluctuations, can also avoid an application for refund by being armed with a certificate of this description.

When these adjustments and refunds are made, it is evident that all persons are finally assessed at rates appropriate to their total income. The only portion of the income to which this statement does not apply is with regard to undistributed dividends of companies. Since it is not possible to apportion the dividends to individual shareholders, the profits continue to be charged at the maximum rate.

As a general rule super-tax is not collected at the source.

[1] This refund is now given only to British subjects or to subjects of Native States. In computing the total income in the case of a non-resident all profits wherever accruing are included—Section 9, Act III of 1928.

[2] *Report of the Central Board of Revenue on the Administration of Income Tax*, 1923–4.

It is levied on the total income which means exactly the same thing as that calculated for income-tax purposes.[1] There is, however, one case in which super-tax from the very nature of things must be stopped at the source, otherwise it would cease to be collected at all. This is the super-tax payable by non-residents. The Indian Income Tax Act of 1922 provided for the collection of such super-tax at the source by section 57 (2), which was as follows:

> "Where any assessee who is liable to pay super-tax on the amount of dividends receivable by him from any company is, to the knowledge of the principal officer of the company, residing out of British India, the principal officer shall be liable to pay the super-tax due by such non-resident person in respect of the dividends received by him from the company, and shall have power to deduct the amount of such super-tax from the amount payable by the company to such assessee."

This section as it stood in 1922 was of doubtful utility owing to the vagueness of the expression "any assessee who is liable to super-tax." It led to considerable inequalities as between a resident shareholder on the one hand and a non-resident shareholder on the other, and also between two non-resident shareholders. Under the provisions of the above section, the principal officer of a company could deduct super-tax only if the dividend exceeded the minimum liable to super-tax. Thus if a non-resident shareholder had an income of Rs.40,000 from one company and Rs.70,000 from another, he would have been liable under section 57 (2) to pay super-tax only on Rs.20,000. If, on the other hand, the same income was derived by a resident, he would have been liable to pay super-tax on an income of Rs.60,000. Again, as between two non-residents, one deriving an income of Rs.60,000 from one company and another deriving the same income from two companies in sums of Rs.30,000 each, the former would have been liable to the extent of Rs.10,000 and the latter not at all.

These inequalities have now been removed by Act XXIV

[1] To this rule there is only one exception. Where an unregistered firm is itself assessed to super-tax, the share of the partner of the firm is excluded from total income for super-tax purposes.—*Income Tax Manual* (1925), Vol. I, p. 147.

of 1926. The Act made it obligatory on the part of the principal officer of every company to notify to the Income Tax Officer annually all dividends paid to shareholders in excess of a sum to be prescribed by rules made under the Act. This obligation was not confined to the case of dividends received by non-resident shareholders alone, but applied to all dividends. The provision now enables the income from different companies to be combined, and taxed at the appropriate rate in the case of shareholders residing out of British India. The Income Tax Officer requests the principal officer of a company to deduct super-tax at a specified rate, and, in the event of the principal officer failing to do so, becomes personally liable for the tax.

The principle of deduction at the source has the great merit that it effectively prevents fraud and evasion. It is also convenient to the honest tax-payer, as under the system he pays the tax at the time most convenient to him. But the one great drawback of the system is that under it the number of applications for refunds is bound to be numerous. This disadvantage is to a great extent minimized in India by the practice, which has already been referred to, viz., that of granting certificates in advance authorizing the deduction of the tax at less than the maximum rate. In Great Britain the principal classes of income from which income tax is deducted at the source are the following : [1]

Stoppage at Source in G.B.

(*a*) Interest on British Government pre-war securities and on certain securities issued since the outbreak of war;
(*b*) Interest on foreign Government securities payable in the United Kingdom;
(*c*) Interest on securities issued by local authorities;
(*d*) Mortgage and other interest payable on real property;
(*e*) Rents, including ground rents, lease rents, head rents, feu duties and similar payments out of real property;
(*f*) Debenture and other interest and dividends paid by limited liability companies;
(*g*) Interest and dividends payable by foreign and colonial companies through agents in the United Kingdom;

[1] *Minutes of Evidence before the Royal Commission on the Income Tax*, 1920, Comd. 288–1, Appendix, p. 7.

(*h*) Coupons for dividends payable abroad which are payable through a banker or coupon-dealer in the United Kingdom ;
(*i*) Patent royalties ;
(*j*) Mineral royalties, and dead rents ;
(*k*) Annual interest and annuities payable under contracts ;
(*l*) Certain tithe-rent charges ;
(*m*) Salaries of officers of Public Departments.

It will be noticed from the above that India relies upon direct assessment in a number of cases in which Great Britain takes recourse to collection at source. Income from mortgages, ground rents, lease rents are instances in point. The question, therefore, arises whether it would be worth while for India to extend this device of deduction at source to these and other incomes. It might seem at first sight that the adoption of this device in India would increase the number of applications for refund to a larger extent than in Great Britain, for in the latter country, leaving aside the case of total exemption, there are only two rates in force, viz., the standard rate and half the standard rate. In India, on the other hand, the number of rates is far more numerous. The contrast between Great Britain and India is, however, more apparent than real ; for in Great Britain, owing to the existence of abatements and reliefs, refunds are necessitated in a large number of cases. If, however, it is felt in India that it would not be feasible from the administrative standpoint to extend the device of collection at the source, other expedients as stated below might be resorted to. But the essential preliminary to any scheme of reform is the frank recognition of the fact that the existing Indian system is unsatisfactory, in so far as it leaves a loophole for evasion.

The alternative remedy which might be suggested is the extension of the principle of " information at the source," as it is called in the U.S.A.—a principle which already finds a limited application in the Indian income-tax law.

Under the provisions of the existing Act it is compulsory for certain persons and institutions to give information to the income tax authorities regarding payments made by

them. For example, all local authorities, companies, public bodies or associations and all private employers are bound to furnish to the taxing authorities a list of persons liable to pay income tax under their employments, as also the payments made to such persons.[1] We have already referred to the provisions of Act XXIV of 1926 under which the principal officer of a company is bound to furnish to the Income Tax Officer a statement showing the amount of dividends in excess of a specified sum paid to the shareholders. The Income Tax Officer may also require any firm to furnish a return of the members constituting the firm.[2] Copies may also be taken of the register of shareholders or debenture holders or mortgagees of any company.[3] These provisions have no doubt been inserted to facilitate the collection of the tax at the source, and there is no reason why this principle should not be extended to cover all rents paid to landlords and interests paid to mortgagees. In the case of registered transactions the registration officer might be directed to send periodically to the Income Tax Officer a list of registered leases and mortgages. Valuable information might be gathered from the municipal authorities, who could be called upon to furnish annually statements showing the names of owners and occupiers of all houses within the municipal limits. The Public Works Department is also in a position to furnish valuable information regarding the payments made to contractors. The banks might be required, on receiving a written request from the Income Tax Officer, to say whether or not any particular assessee has an account with them. They may also be required to produce the accounts of their customers on requisition from an Assistant Commissioner of Income Tax or any other higher officer. There is no doubt that a wider extension of the principle of information at the source would minimize evasion to a large extent and materially improve the receipts from income tax.

Information at the Source.

It is not always practicable to tax income at the source,

[1] Section 21, Act XI of 1922.
[2] Section 38 (1), Act XI of 1922.
[3] Section 39, Act XI of 1922.

and in such cases it is necessary to make a direct assessment on the recipient of the income. To facilitate such assessments the law requires every individual, Hindu undivided family, company, firm or association of individuals to furnish a return of income in a prescribed form. In this respect there is a difference between the legal liabilities of a company and those of other assessees. The liability of a company to furnish such return whether for income tax or super-tax purposes is absolute, and arises irrespective of any notice served by the authorities. In the case of other assessees there is no statutory obligation to make such returns until a notice has been served by the Income Tax Officer.[1] The law on the subject in Great Britain is much more stringent. Shortly after the 5th April in each year a notice is issued to all persons, including companies, who are liable to income tax under Schedule D. Under Schedule A, under which agricultural rents are taxed, a return is called for only in the year of revaluation. Returns are also required under Schedules B and E. The notice which is sent separately to individuals is known as " particular notice." In addition to this particular notice, there are general notices which are posted on doors of market houses, churches, and other public places calling the attention of the tax-payers to their legal liability to send returns. In Great Britain failure to receive a particular notice does not at all absolve one from sending a return.[2] As regards super-tax the duty devolves on persons liable to such tax to notify the fact to the Special Commissioners on or before the 30th September each year. On receipt of such information super-tax forms are sent which must be completed and returned within a specified period.

Paucity and Inaccuracy of Returns.

In India a failure to make returns required by law is visited with various penalties. In the first place the offender is liable to a fine not exceeding Rs.10 for every day of such default.[3] In the second place, the defaulter

[1] Section 22 (2), Act XI of 1922.
[2] *Report of the Royal Commission on the Income Tax*, 1920, paras. 412–13.
[3] Section 51, Act XI of 1922.

loses the right to appeal against any assessment which might be made by the Income Tax Officer in the absence of such returns. Notwithstanding these provisions, a large number of assessees fail to furnish any returns at all, preferring to gamble on the chance of the Income Tax Officer under-assessing them. Again, of the returns filed only a small proportion is accepted as correct. The following table illustrates for 1923–4 to what extent returns and accounts were asked for, and to what extent they were accepted as correct by the authorities.

Province.	Number of Assessees.	Returns Filed.	Returns Accepted.	Accounts called for.	Accounts Produced.	Assessment based on Accounts.
Madras (*a*)	37,133	14,176	4,694	9,573	6,943	6,031
Bombay	66,206	55,702	15,718	40,000	36,061	(*c*)
Bengal	43,314	38,239	14,777	(*c*)	(*c*)	(*c*)
U.P.	25,549	(*b*)	9,269	21,045	10,839	7,810
The Punjab	27,871	20,388	6,949	24,164	16,136	9,074
British Burma (*a*)	16,862	12,145	8,005	5,150	2,433	1,607
Bihar and Orissa	15,069	10,350	1,439	8,957	4,406	3,196
C.P. and Berar	11,575	16,426	4,730	12,083	9,848	7,836
Assam	5,099	3,745	2,307	1,347	1,022	521
N.W.F.P.	4,183	1,633	318	3,931	1,771	760

(*a*) Does not include collections made by land revenue officers.
(*b*) As there is a typographical error in the official report, this figure has been omitted.
(*c*) Figures not given.

The table given above understates the seriousness of the situation to a great extent. For the returns filed were in most cases by salaried persons or by those who were not liable to tax. The reluctance to send returns of income was not by any means a special feature of the year 1923–4, for it has been more or less a prominent feature ever since the law was altered requiring every likely tax-payer to declare his income.[1] In 1925–6 the Commissioners of Income Tax in the various Provinces had to lament the deplorable apathy of the assessees and of the inaccuracy

[1] Sir Basil Blackett spoke as follows in the *Indian Legislative Assembly* on the 12th March, 1928 : " I am afraid it still remains true that the main explanation of the comparatively large proportion of cases in which full accounts are not supplied by the assessees is that it is still their experience that on the whole they get off more lightly if they do not supply accounts."

of such returns as were filed. For instance, 40 per cent. of the cloth dealers in Bombay who had made large profits in that year failed to send in any returns, and took their chance of being assessed at a sum guessed by the Income Tax Officer. Again, of the returns filed in the Bombay Presidency only 21 per cent. were accepted as correct. In the same year in the Punjab, one out of every three assessees failed to furnish a return or to produce accounts, and of those who produced accounts only one in four could be accurately assessed on them. According to the Commissioner of Income Tax of the Punjab only 4,073 (excluding salaried assessees) declared themselves liable, and 17,951 had to be taxed who presumably wished it to be supposed that they were not assessable. Had the assessments been made solely on the basis of returns submitted, the demand would have been Rs.2,200,000 against Rs.7,150,000 the actual figure.[1]

The facts stated above give rise to two distinct but allied problems. The first one is comparatively simple, viz., to induce the assessees to file returns of their income. The second one is to ensure the accuracy of such returns as are actually filed, and prevent fraud and evasion. The income-tax authorities have no doubt powers under the existing statutes to compel the submission of returns by the infliction of fines. But it might be necessary to raise the maximum amount of daily fine leviable under the provisions of the existing law to a higher figure, in order to deal effectively with the richer tax-payers. In Great Britain, besides fines, the defaulter is liable to a penalty of three times the amount of the tax which is ordinarily payable.[2] There is no doubt that a penalty of this kind is far more effective than that provided for in India.

There are reasons to believe that the reluctance of the assessees to submit returns is a temporary phenomenon which is likely to disappear in course of time. The newly created income-tax department during the course of the last few years has collected a large amount of data regarding

[1] *Report of the Central Board of Revenue*, 1925–6.
[2] Konstam: *Treatise on the Law of Income Tax* (1926), pp. 321–2.

the average profits made in the various trades. Such data have been collected mostly from the books of those assessees, who furnish reliable returns, and also to a certain extent from entries in the Government customs house. Records of property owners liable to income tax are also being compiled. As information of this kind at the disposal of the department increases, enlightened self-interest alone would rouse the assessees to a sense of their responsibility. Much might be expected from the extension of the principle of "information at the source" already suggested. There is no doubt that it would facilitate the collection of income tax from such sources as gains of money-lending, with respect to which there is reason to believe there is a good deal of evasion.[1]

This brings us to the allied question of the submission of fraudulent and incorrect returns. The dishonest devices are divisible into two broad categories: (i) the duplication of accounts with a view to present a false balance-sheet before the taxing authorities, and (ii) the submission of partial and inaccurate returns. It is widely believed that the practice of manufacturing duplicate accounts is resorted to by Indian traders, and that it is now tending to increase with the rise in the rates of income tax. But the problem is not a new one, for it engaged the attention of the Government of Bengal as early as 1890. It will be recalled that under the Act of 1886 the income-tax authorities had no power to call for returns or accounts before assessment, but the assessees could produce them in support of their claim to a reduction of assessment. About the year 1890 the tendency to produce adjusted accounts began to show a marked increase in Bengal, and the Government of Bengal concluded from this fact that the mercantile classes were setting themselves to combat the income tax with civilized weapons, and that many of these accounts were specially prepared for the purpose of being filed in appeal against assessment.[2]

[1] Gyan Chand's article: Note on Income Tax for 1924–5 in the *Indian Journal of Economics*, October, 1926.

[2] *Report on the Administration of Income Tax in Bengal*, 1890–1.

These remarks of the Government of Bengal led the Board of Revenue to make a detailed inquiry on the subject. The inquiry elicited a number of divergent and interesting opinions. Many of the senior and experienced district officers refused to join in the verdict of wholesale condemnation which the Government of Bengal had passed. The Commissioner of Rajshahi Division described this belief regarding duplication of accounts as an "assessors' legend," and emphatically denied that this practice was widespread. He observed:

"My own opinion is that the statements as to traders keeping two sets of accounts, one for their own use, one for the satisfaction of the income tax officers originate in the dissatisfaction of the assessors who find their estimates contradicted by authentic records." [4]

Mr. Kilby, who was in charge of income tax in Calcutta, was satisfied that the remark of the Bengal Government certainly did not apply to the Indian traders generally. He said:

"As regards the books produced by native traders, I am not prepared to say that I implicitly believe that they are all genuine, but I certainly think that the majority of them are. Looking at the enormous business carried on by the *Marwaris* of *Burrabazar* and their system of book-keeping, it seems to me to be absurd to suppose that they take the trouble and run the risk of keeping duplicate books simply to save paying a few hundred rupees a year."

The Board of Revenue on a review of all the opinions elicited was, however, more inclined to agree with the Government of Bengal than with those who were actually engaged in the work of administering the tax.

It would be idle to deny that in some instances, at any rate, fictitious accounts were actually produced, but the extent to which such devices were resorted to was exaggerated. It is unlikely that the Indian trader, or for that matter any trader, would go to the length of manufacturing duplicate account books entailing great risk and trouble

[1] *Report on the Administration of Income Tax, Bengal,* 1891–2.

if he could attain his object by cheaper and more expeditious methods. In the first place the omission of specific items of income and the production of partial accounts would serve his purpose if he were dishonestly inclined. Returns might be cooked by the inclusion of certain items whose genuineness and accuracy it would be difficult to determine. One such item is "bad debts." This item was sometimes included in the returns produced at this period to reduce income-tax liability.[1] Even at the present day "bad debts," real or fictitious, sometimes figure in the income-tax returns, and it is a matter of considerable difficulty to test the accuracy of such statements. In the second place traders evaded the tax by the manipulation of accounts between the head office and branch offices. Owing to the intricacy of accounts it was often difficult to ascertain whether certain items of income earned in the country districts had really been included in the Calcutta head office accounts. Methods such as these, which are no less dishonest than the duplication of accounts, enabled the trader dishonestly inclined to evade the payment of legitimate dues, and the belief that the practice of duplication [2] of accounts is widespread must be dismissed as a fiction. On this point we have the testimony in recent times from two authoritative and independent sources, viz., the Government of the United Province and the Madras Chamber of Commerce. Writing in 1920, the Government of the United Provinces felt themselves bound to contradict this belief. They expressed themselves in the following words: [3]

> "No books appear to have yet been rejected as false. The opinion is widely held, it is true, that many traders keep two sets of books of which one is used entirely for income-tax purposes. But no such case has been reported by District Officers. While on the contrary many books which have been produced have contained internal evidence that they have been maintained

[1] Opinion of Mr. Sterndale in the *Bengal Report on the Administration of Income Tax*, 1892–3.

[2] One variant of this belief is that three sets of accounts are usually maintained, one genuine for the active partner, and the other two both fictitious meant for the sleeping partner and the income-tax authorities.

[3] *Report on the Administration of the Income Tax in the United Provinces*, year ending March, 1920.

without any idea of their being requisitioned for income-tax purposes."

Equally strong is the testimony of the representatives of Madras Chamber of Commerce before the Indian Taxation Inquiry Committee. They described the belief as "more a tradition than the actual fact." [1]

Whatever may be the nature of evasion, whether it is practised by duplication of accounts or by the submission of partial and inaccurate returns, the fact remains that evasion continues on a very large scale, and that there is a good deal of substance in the statement that income tax as administered in India to-day is a "tax on honesty." Provisions no doubt exist in the Income Tax Act to deal with cases of positive dishonesty. A person making a wilfully fraudulent return is liable to criminal prosecution and is punishable with fine and simple imprisonment.[2] As an alternative to criminal prosecution, the dishonest assessee is liable to pay a penalty not exceeding the amount of tax which he attempted to evade. But these powers are to a large extent useless, because it is extremely difficult to establish in a court of law a charge of wilful and deliberate falsification of accounts, as in many cases a knowledge of the amount of income is confined only to the assessee. Nearly one-third of the criminal prosecutions started during 1922–3 to 1925–6 in connection with various offences under the Indian Income Tax Act ended in failures, and there were several instances in which offences were compounded on receipt of substantial sums, owing to the uncertainty inherent in criminal prosecutions.[3]

It is evident that, in spite of the existence of wide penal

[1] Vol. VIII, *Indian Taxation Inquiry Committee*, p. 141—Evidence of Messrs. T. M. Ross, W. R. T. Mackay, and Graham Ross.

[2] Section 52 Income Tax Act, 1922, and sections 177 and 182 of the Indian Penal Code.

[3] The difficulty of securing conviction in a court of law may be illustrated from the following actual case which occurred during 1924–5 in the Punjab. A partner of a firm was accused of offering five Rs.100 currency notes as bribe to an Income Tax Inspector. The defence of the accused was that he had the currency notes in the pocket which also contained his handkerchief, and that the notes dropped from his pocket in the house of the Inspector where he happened to blow his nose. The accused was acquitted.—*Report of the Central Board of Revenue*, 1924–5.

powers in the hands of the authorities, powers which must be regarded as sufficient for all practical purposes, the law has failed to ensure the submission of accurate returns. The explanation of this seeming anomaly is to be found in the fact that it is futile to expect satisfactory results from the penal provisions of law, when a good deal depends upon the education of the assessee. People must be made to realize that it is mean and despicable to defraud the Government, and that by evading the payment of their legitimate dues they throw a disproportionately heavy burden on the rest of their fellow-men. The education of the assessees along these lines is a question of time, especially in view of the political difficulties in the way. Many of the assessees now labour under the delusion that by under-estimating their income they are simply defrauding an abstract entity—the Government. With the growth of political and civic sense among the tax-payers evasion is likely to be much less than at present.

Remedies.

It would, however, be a mistaken policy to fold our hands and wait patiently till such time as the public conscience of India may be roused. There are reasons to believe that not infrequently the submission of inaccurate returns is due merely to ignorance. The report on the working of the income tax for 1923–4 admitted that the submission of inaccurate returns was often due to this cause. The assessees do not study with sufficient care the instructions given in the forms issued by the department. In so far as loss of revenue is caused by negligence and ignorance of this character, fruitful results might be expected from the issue of pamphlets in the different vernaculars explaining the manner in which accounts are to be kept, and the items that are to be included in the returns. The assessees must also be made to realize that they have nothing to lose from the submission of correct returns and everything to gain. It is a matter of common knowledge that professional men with fluctuating incomes, though not always dishonestly inclined, are often reluctant to send in correct returns. They are under the impression, rightly or wrongly, that once they admit the possession of

a high income, they may not be able in future to obtain a reduction of assessment, even if their actual income justified such reduction. This apprehension, that the income of each year is made the starting-point for enhanced assessment in the next, is to a large extent a legacy from the past when returns were not called for, and the authorities were left to guess the income as best as they could. With the provision for compulsory submission of returns the use of such slap-dash methods of assessment is absolutely out of place, and it is up to the newly created income-tax department to demonstrate that an honest assessee need have no fear on this score.

Publicity in its various forms is also one of the most powerful instruments that might be utilized in reducing frauds upon revenue. One form of this remedy is that which has been suggested by the Taxation Inquiry Committee. The Committee recommended that the names of persons who were penalized for income tax offences should be published in the annual reports, so that the offenders might be made to feel the ignominy and disgrace attaching to their misdeeds. This remedy is in force in Australia and might no doubt be tried in India, but it is doubtful whether it would be immediately effective having regard to the prevailing illiteracy and the absence of any serious social disgrace attaching to successful evasion. Another form of publicity which might be found useful is the publication in the Press of the particulars of incomes subjected to taxation. These details are published in Sweden, while in some American States the income-tax rolls are public records. There is no doubt that the publication of the income-tax payments, even under existing conditions in India, would result in an improved collection. This step is, however, likely to be strenuously opposed by the trading classes who rely for the supply of their capital on their credit in the bazaar.[1]

This brings us to consider another kind of evasion, viz.,

[1] Evidences of Sir Gordon Fraser and Khan Wali Muhammad Sahib, Commissioner of Income Tax, C.P.—*Indian Taxation Inquiry Committee's Report*, Vols. III and IV.

that in which dishonest assessees find it to their advantage to use the forms and provisions of law for the purpose of defrauding the Government. The authorities are powerless under existing conditions to deal with frauds of this kind, because the law itself provides opportunities for the legal avoidance of the tax. It has already been pointed out that under the Income Tax Act the members of a registered firm are ultimately taxed on their individual share of profits at a rate appropriate to their separate income. Under the circumstances it is easy to evade the payment of income tax and super-tax by taking one's wife and minor children as partners, with a view to obtain the advantage of paying income tax at a low rate. The way to stop this palpable and flagrant evasion is to lump together the income of the husband and wife for the purpose of computing the amount of tax to which they are jointly liable. We have seen that it is eminently desirable from the social standpoint to treat the income of the family as the unit, quite apart from any consideration of preventing evasion, and the remedy proposed while effectively checking evasion would at the same time amount to a reform of income tax on rational lines. In addition to this remedy it will also be necessary to ensure that the partners are genuine, and that profits are actually distributed in a manner stated in the instrument of partnership. For this purpose power may be given, as suggested by the Taxation Inquiry Committee, to Income Tax Officers to impose heavy penalties in cases where a loss of revenue has arisen through a failure to distribute profits in accordance with the terms of partnership.

Legal Evasion.

Just as a registered partnership derives an advantage by increasing the number of partners, similarly an unregistered partnership seeks to obtain the same unfair advantage by breaking up the business into a series of unregistered firms; for the greater the number of such firms, the greater the nominal division of income for the purpose of income tax, while as regards super-tax as many deductions of Rs.50,000 are claimed as there are firms. To put an

Remedies suggested by the Taxation Inquiry Committee.

end to this state of affairs the right to be treated as an unregistered partnership should be restricted. A discretionary power should be given to the Income Tax Officer to treat unregistered firms precisely in the same way as a registered firm, even if the partners have not registered the partnership. It might, however, be apprehended that the arbitrary power thus given to the Income Tax Officer might be used to harass small tax-payers. This apprehension is groundless, for the authorities have nothing to gain in the case of small tax-payers by treating them as registered partnerships, for the effect of so treating them would be to extinguish the liability altogether.

A company is also sometimes split up in order to evade payment of super-tax, for each of the constituent companies thereby becomes entitled to a deduction of Rs.50,000 for super-tax purposes. The conversion of the existing super-tax on companies into a corporation profits tax, without the benefit of minimum of exemption, would remove the existing incentive to the formation of such companies. Yet another method by which shareholders evade the payment of super-tax is by the formation of what are described as "one-man companies." The appearance of these companies in Great Britain led the Royal Commission of 1920 to suggest appropriate remedies for dealing with them. As the undistributed profits of companies are not liable to super-tax either in Great Britain or in India, it would pay to allow all the profits of a company to remain undistributed, provided the company was controlled by an individual alone or in conjunction with his near relatives. The shareholders, if they could live upon the income from other sources, would not lose anything by refraining to declare a dividend at all. Again, if a reduction in the super-tax was anticipated, considerable savings could be effected by postponing the distribution of dividends. A slight variant of the device is to give loans at a nominal rate of interest to the shareholders without any intention of calling back the amount loaned. As the loans are not taxable the evasion of the super-tax is complete. The

Taxation Inquiry Committee urged [1] that the most effective way of dealing with these "one-man companies" was to take action along lines laid down in section 21 of the British Finance Act of 1922. This section lays down that if a company, which has not issued any of its shares as a result of public invitation, is controlled by not more than five persons, and the number of shareholders is restricted to fifty or less it should be treated as a firm and the super-tax levied on the entire profits.[2] But in order that this remedy may be effective in India the opportunities for evasion which at present exist by the creation of bogus firms must first be put an end to.

It might, however, be urged by business men that the vesting of discretionary power along lines suggested by the Taxation Inquiry Committee would mean bureaucratic control of trade and industry and direct State interference in the enterprise involved. To this contention it is a sufficient answer that such interference is not resented by industrialists when it is invoked for the purpose of safe-guarding industries or when wide discretionary powers are given to the executive to stop the inflow of "dumped" goods. If Great Britain, the classic home of individualism, has found it necessary to arm the income-tax authorities with these powers, there can be no reasonable objection to their being exercised in India, where the State has always arrogated to itself wider power in the domain of industry.

Even when comprehensive measures have been adopted to check various kinds of evasion—legal and extra legal—there would yet remain a residue of leakage which it would be difficult to prevent under any system of income-tax administration. For this is a defect which is inherent in a direct tax as an instrument of finance. Even in Great Britain with nearly a century of experience, where

[1] A bill embodying many of the above recommendations of the Taxation Inquiry Committee was referred to a Select Committee of the *Indian Legislative Assembly* on the 20th February, 1928.

[2] By the Finance Act, 1927, certain additional powers were given to the executive in Great Britain to deal with "one-man companies."—See *House of Commons Debates* (Vol. 208, No. 92), 4th July, 1927.

income-tax administration is admittedly one of the best [1] in the world, the loss of revenue due to evasion was variously estimated at £5 to £10 millions.[2] In India the question is not so much one of improved administration as of healthier and more powerful public opinion. It is sometimes given to the Chancellor of the Exchequer in Great Britain to acknowledge in the Press the receipt from anonymous contributors of what is described as "conscience money," which represents arrears of taxes evaded by dishonest assessees. These persons, stricken by bitings of conscience, sometimes think it their duty to square up their accounts with the Treasury. One would like to see very much in India even belated stirrings of conscience of this kind, rather than the apathy which makes reform difficult.

Healthy Public Opinion Needed.

[1] Keynes wrote as follows: "Somerset House, one of the best run and most useful institutions in this country, a remarkable creation of the British genius for administration."—*Economic Journal*, June, 1927.

[2] *Report of the Royal Commission on the Income Tax*, 1920, para. 627.

CHAPTER XIV

THE TAXATION OF AGRICULTURAL INCOMES [1]

Taxation of Agricultural Income during 1860–5 and 1869–73.

No feature of the tax system of India distinguishes it so sharply from the British as the exemption from income tax of agricultural rents and agricultural profits. While in Great Britain agricultural rents and profits are brought under taxation under Schedules A and B respectively, such incomes, as we have already seen, have been exempt from taxation in India since 1886. Suggestions have been put forward from time to time to the effect that the mistake made by the early British administrators in effecting a permanent settlement of land revenue in Bengal and Behar should now be remedied by imposing an income tax on agricultural rents. Similar taxation proposals, but on a restricted scale, have been put forward with regard to temporarily settled areas as well.[2] In this chapter the question of a tax on agricultural incomes will be discussed first with reference to Bengal, and then with reference to the temporarily settled areas generally.

Few questions on Indian finance have given rise to greater controversy in recent times than the one connected with taxation of agricultural incomes in Bengal. The proposal to levy an income tax on agricultural incomes in this Province has been vehemently denounced as a violation of the terms of the permanent settlement, as "absurd" and

[1] A section of this chapter, viz., that dealing with the taxation of agricultural income in Bengal, was read before the *Indian Economic Conference* held in Calcutta in January, 1927. The paper was published in the *Indian Journal of Economics* (Conference Number, 1927) and also in the *Calcutta Review*, January–February, 1927.

[2] See an article by B. G. Bhatnagar on "Thoughts on Indian Finance" in the *Indian Journal of Economics*, April, 1925.

"unpractical," and as emanating from a desire to "seek cheap distinction."[1] With equal warmth it has been advocated as necessary to correct a long-standing anomaly and an apparent injustice. Amidst the confusion of discrepant counsels, the country expected a clear and confident lead from the Taxation Inquiry Committee. The Committee, however, instead of giving an unequivocal verdict on the issue thus clearly framed, admitted the theoretic justification for such a levy, but dwelt on what they described as "political" and "administrative" difficulties.

A review from the historical standpoint of the effects of the taxation of agricultural income in British India during 1860–5 and 1869–73 may not be without some value in the present controversy.

India's first income tax levied in 1860 brought under taxation the various categories of income irrespective of the source from which they were derived. Income from lands and houses, from professions, trade and employment and from annuities and dividends were all placed on the same footing as regards taxation, because, as Mr. Wilson put it, "an income tax to be just ought to be universal and equal in its application to all alike within a certain limit of income." This canon of universality as an essential feature of income tax was also emphasized by his successor Mr. Samuel Laing, who observed in 1861 that the capital and trade of India as well as her land should contribute in fair proportion towards the support of the State.

The rules regarding the taxation of income from land were elaborated in the 97th section (Part 6) of Act XXXII of 1860. So far as the temporarily settled areas were concerned, it was laid down that the profits from land were to be estimated at one-third of the land revenue. As the taxable minimum under the Income Tax Act of 1860 was fixed at Rs.200 a year, it follows that in these areas only persons paying a land revenue of Rs.600 a year or more were liable to pay income tax in respect of their

[1] *Vide* written evidence of the East Bengal Landholders' Association, Dacca, in the *Taxation Inquiry Committee's Report*, Vol. V, p. 549.

agricultural income. In all other cases, as, for example, with regard to Bengal, the law was that actual returns were to be submitted by the owners, "together with a rent roll containing the name of every person to whom such lands or houses or any part thereof are underlet by the person making any such return." The income tax was imposed on the actual profits from land thus ascertained. The necessity for submitting such a rent roll arose from the fact that the tax was chargeable not only on the *zemindars*, but also on the actual cultivators of the soil. It is necessary to remember this fact when passing a verdict of condemnation on all proposals to tax agricultural incomes in India, for it must be conceded that in thus trying to tax the income of the cultivators the Government of the day wanted to do what was wellnigh impossible. The determination of the farmers' profits is a matter of considerable difficulty even in advanced Western countries. In a country like India, where the farmers are illiterate and are not in the habit of keeping accounts, these difficulties are increased a hundredfold. The proposals to tax agricultural income in Bengal that have been made recently are not of this all-embracing character, for they do not go to the length of suggesting that the farmers should be taxed on their profits from agriculture.

This attempt to tax the agricultural income for the first time was bound to raise the question whether such taxation was legal, having regard to the terms of the permanent settlement; and it is interesting to inquire at this stage what the official supporters thought about the measure, and with what feelings it was regarded by the landed interests whose income was thus brought under a general scheme of income tax. Mr. Wilson anticipated that the cry of "broken pledge" would be raised, and he took care to make the position of the Bengal *zemindars* perfectly clear. He said that it was never in the mind of Lord Cornwallis that the fortunate landowners of Bengal should be exempted from any general tax that the necessities of the State required. There was no word as to exemption from taxes in the proclamation issued by Lord Cornwallis. Equally emphatic

"The sense of my obligation teaches me that it becomes an act of duty in me as a subject of my Gracious Sovereign not only to cheerfully acquiesce, but also to tender my humble support in aiding your new system to relieve our unavoidable financial difficulties. Permit me, sir, most respectfully to assure you that the immediate cause for the expression of my opinion is the attempt which has been made to oppose your admirable system of taxation—this opposition being founded upon the false assumption that it is a breach of the perpetual settlement.

"No doubt at the time the settlement was made it was considered as sufficient for the exigencies of those days, but I cannot find anything in the terms of the permanent settlement to convince me that the zemindars of India have for ever been exempted from contributing to assist the Government when they incur unavoidable expenses in preserving property, life, the honour and all that is dear to them of those very zemindars. Sir, I as the greatest zemindar disclaim all such exemption. I am willing to submit most cheerfully to your wise system of taxation, which places this unavoidable impost equally on all classes. If you think that this declaration of mine, which is the result of mature consideration, will be any guide to my countrymen, if you think that the example thus set by the greatest proprietor of zemindaries in Bengal can induce his countrymen to believe that it is true to policy to surrender a portion for the security of the whole, I place in your hands my adherence to that admirable system of taxation by which, in my belief, your memory will be endeared to India."

Whilst on this subject reference may also be made to the despatch of the 12th May, 1870, from the Secretary of State to the Governor-General in Council, in which the position of the Bengal *zemindars* was examined, and their legal liability with regard to the payment of income tax explained. Referring to the promise contained in the Regulations of 1793 that the public demand was fixed, the Secretary of State said:

"The public demand was to be fixed and permanent, such was the promise, and its scope and object were clearly explained in the concluding exhortation addressed to the landowners that they would exert themselves in the cultivation of their lands under the certainty that they would enjoy exclusively the fruits of their own good management, and that no demand would ever be made upon their heirs and successors by the present or any future Government for the augmentation of the public assessment *in consequence of the improvement of their respective estates.*"

The Secretary of State then proceeded to say that it was quite true that the income tax was in the fullest sense of the word a "public demand." But there was one thing which that tax was not. It was not an increase of public demand levied upon the *zemindars* "in consequence of the improvement of their respective estates." He remarked that it was levied upon a wholly different principle and in respect of a wholly different kind of liability. One index and proof of this difference lay in the fact that although this public demand was made upon those to whom the promise of the permanent settlement had been given, it was made upon them only in company with other classes of the community, and with no exclusive reference to the source from which this income was derived.

We may now pass on to consider the operation of the income tax in Bengal during 1860–5 and 1869–73 with a view to find out what the contributions of Bengal *zemindars* were by way of income tax, and to what extent, if at all, administrative difficulties stood in the way of the smooth working of the tax. It has been contended that the bulk of the *zemindars* of to-day are very poor, and that in Bengal at the present time a sum of Rs.98,600,000 is intercepted by as many as 3,656,000 landholders of all grades, thus giving an average income per *zemindar* of Rs.28 a year.[1] Arguments of this character based on average are absolutely misleading, for with equal plausibility it may be argued that since the average income of an Indian is only Rs.80 or so, Indians as a class are too poor to pay income tax, or for the matter of that any tax whatsoever. In trying to determine the taxable capacity of a community or any particular section of it, what we primarily want is not the average income but the distribution of income. A rough idea of the distribution of income in Bengal, both agricultural and non-agricultural, during 1860–5, may be obtained from the following table:

[1] Evidence of Sir P. C. Mitter before the *Taxation Inquiry Committee*, Vol. V, p. 480.

TABLE I[1]

SHOWING THE INCOME TAX ASSESSEES, AGRICULTURAL AND NON-AGRICULTURAL, 1860–1865

Year.	Total Number of Persons Assessed to Income Tax in Bengal.	Number of Landholders and others deriving their Income from Landed Property and Assessed to Income Tax in Bengal.
1860–1 . . .	251,261	100,715
1861–2 . . .	254,537	97,198
1862–3 . . .	63,876	33,415
1863–4 . . .	60,188	32,462
1864–5 . . .	53,115	32,200

In interpreting these figures we must remember that the minimum taxable income was Rs.200 a year during 1860–2 and Rs.500 during 1862–5. The conclusion which may be drawn from these figures is that the landholders and others deriving their income from landed property constituted by far the largest proportion, ranging from nearly one-third to one-half of the aggregate income tax-payers. Not only did they constitute by far the largest proportion, but they contributed half the aggregate receipts from income tax. This will be evident from the table given below:

TABLE II[2]

Year.	Total Demand for Income Tax, Bengal.	Amount of Tax paid by Landholders and Others deriving their Income from Landed Property in Bengal.
	Rs.	Rs.
1860–1 . . .	4,639,536	2,317,839
1861–2 . . .	4,219,902	2,210,012
1862–3 . . .	3,241,320	1,831,687
1863–4 . . .	2,350,127	1,339,398
1864–5 . . .	2,072,892	1,309,830
Total .	16,523,777	9,008,766

[1] *Final Report on the Operation of the Income Tax in the Lower Provinces of Bengal*, 1867. The figures given in this table and the following one do not include those of Calcutta. The income tax in Calcutta was administered by a Commission whose proceedings were independent of the Board exercising jurisdiction throughout the rest of Bengal.

[2] *Final Report on the Operation of the Income Tax in the Lower Provinces of Bengal*, 1867.

These receipts, of course, include the contributions of the cultivators. The figures available for 1860–5 do not enable us to specify what proportion of this amount came from this source, but it would not be incorrect to assume, in view of the more definite figures available for 1870, that this contribution formed a small proportion of the total receipts. The Taxation Inquiry Committee have come to the conclusion that the tracing out of the share of the receipts of the intermediate holders of land is an impossible tax. Obviously in those early days when the income tax was new to the country and was regarded more or less a fiscal innovation, the Government did not find the administrative difficulties of assessment insuperable.

For the second time in the history of Indian finance agricultural incomes were brought under taxation during the period 1869–73. This period, as we have seen, was one of "continuous trial and error"; the rate of the tax as well as the taxable minimum were adjusted from year to year, as the Government were trying to find out a rate and a taxable minimum which would cause as little hardship as possible and would at the same time yield a substantial revenue. The gross collection of income tax in Bengal during 1869–70 from all sources, agricultural and non-agricultural, amounted to Rs.3,366,181, out of which the proprietors, sub-proprietors, tenants and cultivators of land contributed a little more than Rs.1,476,000. The assessees, including the landholders and cultivators, were divided into five classes according to the amount of their income. The lowest class (Class I) consisted of those whose incomes ranged between Rs.500–1,000 a year. Higher incomes were classified as follows:

Class	II	between	1–2 thousand rupees.
Class	III	,,	2–10 ,, ,,
Class	IV	,,	10 thousand—1 lakh of rupees.
Class	V	,,	1 lakh—upwards.

TABLE III

SHOWING THE CLASSIFICATION OF ZEMINDARS, ETC., ACCORDING TO THE AMOUNT OF THEIR INCOME DURING 1869–70

	CLASS I. Income between Rs. 500–1,000.		CLASS II. Income between Rs. 1,000–2,000.		CLASS III. Income between Rs. 2,000–10,000.		CLASS IV. Income between Rs. 10,000–100,000.		CLASS V. Income Rs.100,000 upwards.	
	Number.	Amount of Tax Paid.	Number.	Amount of Tax Paid.	Number.	Amount of Tax Paid.	Number.	Amount of Tax Paid	Number.	Amount of Tax Paid.
		Rs.		Rs.		Rs.		Rs.		Rs.
(*a*) Proprietors and Sub-Proprietors	15,744	150,786	4,783	101,936	4,123	250,154	783	275,045	50	162,162
(*b*) Tenants . .	11,351	105,510	1,528	29,226	574	29,788	10	4,987	—	—
(*c*) Cultivators .	31,928	304,149	2,036	41,181	374	17,424	40	4,492	—	—

According to this classification (*a*) the proprietors and sub-proprietors, (*b*) tenants, and (*c*) cultivators were divided 1869–70 as shown in table III.[1]

It will be noticed from this table that the total number of proprietors and sub-proprietors, tenants and cultivators paying income tax on a minimum annual income of Rs.500 a year numbered 73,324, distributed as follows:

Proprietors and Sub-Proprietors	25,483
Tenants	13,463
Cultivators	34,378
	73,324

Thus of the class which derived their income from agriculture, the most numerous was the cultivators. But this class, though numerically large, was not very important from the point of view of the yield of the tax, for it contributed a sum of Rs.367,246 out of a total contribution of Rs.1,476,840.

It may at once be admitted that much of the unpopularity of the income-tax administration of this period was due to the attempt to tax the cultivators, and, if the history of this period has any lesson for us at the present time, it is that the repetition of this attempt can only end in exciting bitter and hostile feelings against the Government. A good deal of the harshness of the tax arose from the rough and ready method of arriving at the profits of cultivators. Thus Rs.5 was usually taken as the standard profit per *bigha* for rice cultivation. The Collector of Midnapur took Rs.75–80 as the profits per *bigha* for mulberry, while the Collector of Malda took Rs.814 per *bigha* as the standard profits for mango grafts. It is no wonder that hardship resulted from a system like this. The Lieutenant-Governor of Bengal, while reviewing the operation of income tax during 1869–70, observed:

"I am therefore not surprised to find that in the Board's report of 18th July, 1870, it is stated that the income tax falls

[1] *Annual Report on the Administration of Income Tax in Bengal during* 1869–70.

with the greatest severity on the class of ryots and agriculturists . . . that among them more than others a strong and bitter feeling has been excited by the tax, and that instances have been brought to the notice of a member of the Board in which cultivators threaten to migrate to Nepal, where there is no income tax."

In a note dated the 20th January, 1872, the Governor-General expressed himself strongly about the need of relieving the cultivating classes from the effects of a system which he described as one of extreme tyranny and "down right robbery." The Lieutenant-Governor accordingly ordered that holdings not exceeding 50 acres should be exempt from income tax. This order, coupled with the raising of the exemption limit in 1871–2 and 1872–3, had the desired effect of relieving the cultivators from harassment.

In trying to form an estimate of the yield of the taxation of agricultural income at the present time in Bengal, we should therefore deduct the contributions of cultivators. Deducting this amount we find that the proprietors, sub-proprietors and tenants paid a sum of a little over Rs.1,109,000 as their share of the tax. It will be recalled that the taxable minimum was fixed at Rs.500 in 1869–70. The raising of this limit to Rs.2,000 (the existing level) would have reduced this contribution to Rs.722,000. This estimate is arrived at from the following figures taken from table III given above:

	Rs.
CLASS III:	
Proprietors and Sub-Proprietors . .	250,154
Tenants	29,788
CLASS IV:	
Proprietors and Sub-Proprietors . .	275,045
Tenants	4,987
CLASS V:	
Proprietors	162,162

If the lowest rate of income tax existing to-day (viz., 5 pies in the rupee) had been imposed uniformly in 1869–70

this yield would have increased to Rs.12 lakhs. With the application of the principle of graduation the yield would have been considerably larger.

It might be urged against this estimate that owing to continued subinfeudation and partition that have taken place since 1870 the number of *zemindars* with large incomes to-day was likely to be considerably less. In support of this view it was urged before the Taxation Inquiry Committee in 1925 that there were only 650 zemindars in Bengal who possessed a minimum income of Rs.12,000 a year.[1] This figure is arrived at from an analysis of the voters' list of the Indian Legislative Assembly. Now, on referring to table III we find that in 1869–70 the number of proprietors, sub-proprietors and tenants with an income of Rs.10,000 a year or more was 843. It must be remembered in this connection that Bengal of those days was larger in area. After making due allowance for this fact and also for difference in the basis of comparison (the basis of comparison being a minimum income of Rs.10,000 in one case and Rs.12,000 in another), it would appear that, roughly speaking, the distribution of agricultural income to-day is not materially different from what it was sixty years ago. As regards lower grades of income—incomes ranging between Rs.2,000–10,000 a year—definite figures are not available to show what the existing distribution is. But we are aware of no evidence indicating that subinfeudation and partition have affected them in a greater degree than incomes higher up the scale. It is, however, possible to urge that as the size of the family varies inversely in proportion to income, the estates of the smaller proprietors have presumably been partitioned amongst a larger number of heirs. The validity of this contention is admitted, but it is necessary to bear in mind in this connection that lands are being continuously bought and sold. Simultaneously with the process of subdivision and partition there is going on a process of unification, as a result of which many of the smaller estates are being consolidated into larger units.

[1] Evidence of Sir P. C. Mitter before the *Indian Taxation Inquiry Committee*, Vol. V, p. 480 *et seq*.

The circumstances which led to the exemption of the landed proprietors from income tax in 1886 have been referred to in a previous chapter.[1] When the provincial licence taxes were converted into a general income tax in 1886, the existence of the cesses on land in some measure justified this exemption. Since then there has taken place a radical transformation in the character and purpose of the cesses. In 1905 the Government of India inaugurated the policy of confining these taxes for local purposes only. As the Government anticipated a large surplus they proposed to utilize it in the remission of taxation. In fulfilment of the policy of confining the cesses on land for purely local purposes, all the Acts under which cesses were levied for Provincial purposes, including those imposed for the relief of famines, were abolished. Thus the famine cesses in the United Provinces, the Punjab and the Central Provinces were abolished at a total cost of over 22 lakhs of rupees.[2] But a portion of the receipts from the Public Works Cess levied in Bengal continued to be credited to the Provincial exchequer. In 1913–14, in accordance with the recommendations of the Decentralization Commission,[3] the receipts from this source also were made over to the local bodies. The result is that no charge is at present imposed on land except land revenue and local rates. There is, therefore, nothing in the history of the case to justify the continuation of the exemption of the landed proprietors. If to-day this exemption is discontinued, it would mean not the violation of the Regulations of the permanent settlement, but a repeal of section 4, clause (3) (*VIII*) of Act XI of 1922 (the Indian Income Tax Act.) The only argument in favour of the continuation of this exemption is that lands have been bought and sold on the basis of this exemption, and that the buyer has paid a higher price for land in consideration of this exemption. It may, however, be pointed out that so far as a present buyer is concerned he will be compensated by the general development

Exemption of Agricultural Income since 1886.

[1] See Chapter VIII. [2] See *Financial Statement* for 1905–6.
[3] Pars. 766–73, *Report of the Royal Commission on Decentralization*, 1909.

of the country before many years are over. Besides, no citizen has a right to claim that his position must be made secure against all changes in taxation, particularly when no promise, express or implied, was given that the exemption from income tax would be continued for all time to come.

The question of the imposition of a tax on agricultural incomes in the temporarily settled areas, both *zemindari* and *ryotwari*, requires to be approached from a slightly different point of view. In these areas the theoretic justification for the levy of a general income tax is prima facie lacking. As the land revenue is subject to periodical revision, it might with some plausibility be argued that the State has other means of demanding an adequate contribution from land. While the general soundness of this position may be conceded, there is a strong case for the imposition of a tax on larger agricultural incomes in the temporarily settled areas as well.

Taxation of Agricultural Income in Temporarily Settled Areas.

In this connection it is usual to discuss the question whether the land revenue is a tax or rent. Generally speaking, the official view has been that it should be classified as rent, the State being regarded as the proprietor of land. On the other hand, the popular Indian view has been that the Government of India never succeeded to absolute proprietary right in land, and that land revenue should be regarded as tax collected by virtue of the sovereign right of the State. Eminent authorities are cited by controversialists on both sides in support of their contentions. J. S. Mill, Fawcett, James Wilson, Strachey and a host of other authorities favour the view that land revenue is rent, while equally distinguished authorities are inclined to take the other view.[1] The Indian Taxation Inquiry Committee could come to no unanimous finding on the

[1] See the decision of the Madras High Court in the *S. of S. for India versus Penumecha Venkatapathiraju Garu and another* in Madras Weekly Notes, 1912, p. 124; also the Note of Dissent by Mr. Sullivan, *Report of the Indian Famine Commission*, 1880, p. 183. These and other opinions on the subject are given in Appendix IV of Vol. II of the *Report of the Taxation Inquiry Committee.*

issue. They pointed out that so far as the temporarily settled areas were concerned there were certain features of land revenue which made it analogous to a tax, while other features made it resemble a rent. Mention may be made of the fact that there is no restriction on the *ryot* to sell or mortgage his lands, and that the process of collection of land revenue is akin to that of the collection of a tax.[1] On the other hand, the Committee could not ignore the fact that sometimes the State in India performed many of the functions of a landowner, e.g., the grant of loans and of rent-free houses to payers of land revenue. It is futile to join in this controversy which Baden Powell describes as a profitless "war of words," for so far as the subject under discussion is concerned no final conclusion can be reached in this way.

What is most important from our point of view is to emphasize one feature to which the Indian Taxation Inquiry Committee have drawn our attention. This is the extreme inequality in the tax-paying capacities of different classes of landholders.[2] At one end of the scale are the big landholders who pay a comparatively small portion of the economic rent as land revenue. At the other end comes the cultivator of the small uneconomic holdings struggling with difficulty to make both ends meet. Under the existing Indian system, so far as the assessment of land revenue is concerned, these two classes are placed on exactly identical footing. The result is an absence of the element of progression in the taxation of the income derived from land. This is a conclusion which is in no way affected by our verdict on the controversy whether land revenue is in the nature of a tax or rent. The tendency in European countries is to combine a tax on the annual or capital value of land at a flat rate, with a progressive tax on income including that derived from land. It is by this device that inequality of the kind existing in India is obviated.

One of the remedies for this inequality is to impose a tax on the larger agricultural rents in the temporarily

[1] *Report of the Taxation Inquiry Committee*, p. 67.
[2] See *Report*, pp. 77, 79 and 357.

settled areas. Statistics are not available to show the existing distribution of agricultural income in British India.[1] But if the scheme should prove financially productive, there would be ample justification in theory for the proposed course. It has to be borne in mind that the practice of fixing the assessment for long periods renders the machinery of land revenue unsuitable for introducing an element of elasticity in the Provincial tax system. Then, again, the investment of capital in land is seldom attended in India by the performance of productive functions. Theoretically speaking, there is justification for the discrimination between the income derived from ownership and that derived from service.[2]

Division of Income Tax between Central and Provincial Governments.

It is not within the scope of the present monograph to indicate the theoretically correct distribution of resources between the Government of India on the one hand and the Provincial Governments on the other. That is a subject intimately bound up with the larger question of the future of constitutional reforms in India. But a few observations may be made on the vexed question of the distribution of the proceeds of income tax between the Government of India and the Provincial Governments. The financial arrangement under the Reform Scheme was based on the idea that there should be a clear-cut division of resources between the Central and Provincial Governments. This idea led to the abolition of divided heads of revenue and income tax became a Central source. As a slight departure from the scheme of clear-cut allocation of resources, the Joint Select Committee of Lords and Commons recommended " that there should be granted to all Provinces some share in the growth of revenue from taxation on

[1] Neither the volumes dealing with agricultural statistics in British India, nor the annual reports on the land revenue administration in the several Provinces give these figures. So far as Bengal is concerned, the figures given in the Final Report on the operation of income tax, for 1867 and those in the Annual Administration Report, 1869–70 have been utilized. Similar figures for the Bombay and the Madras Presidencies are not available.

[2] See Prof. C. J. Hamilton's evidence before the *Taxation Inquiry Committee*, Vol. V, pp. 82–97.

incomes, so far as that growth is attributable to an increase in the amount of income assessed." The object was to give to the Provinces some share in the increased receipts arising from progress. With that end in view Devolution Rule 15 laid down as follows:

"Whenever the assessed income of any year subsequent to the year 1920–1 exceeds in any Governor's Province or in the Province of Burma the assessed income of the year 1920–1 there shall be allocated to the local Government of that Province an amount calculated at the rate of 3 pies in each rupee of the amount of such excess."

But the figures available show that this Rule has failed to carry out the object which the framers had in view. The Provincial shares of income tax during 1925–6 and 1926–7 are shown in the table below:[1]

	1925–6.	1926–7.
	Rs.	Rs.
Madras	427,084	464,228
Bombay	—	—
Bengal	—	—
United Provinces	2,504	—
The Punjab	382,372	402,341
Burma	892,174	1,431,607
Behar and Orissa	241,320	324,361
Central Provinces and Behar	135,687	217,893
Assam	529,456	492,008
	2,610,597	3,332,438

It is evident that so far as Bombay and Bengal are concerned they have not profited under the existing arrangement.

Much of the unpopularity of the Reform is due to the financial stringency from which most of the Provincial Governments at present suffer. While all the expanding heads of revenue, like customs, income tax and income from railways, etc., are appropriated by the Central Government,

[1] *Finance and Revenue Accounts.*

large to enable them to carry on their provincial affairs.[1] Even the existing arrangement in India sanctioned under the Devolution Rule 15 is not free from the taint of "divided heads." The modification of the system on more rational lines should not necessarily mean the curtailment of the financial powers of the Provinces. The system of segregation of sources of revenue coupled with the division of the yield seems to offer a solution of the difficulty which at present confronts the Provincial Governments.

[1] Villard and Willoughby: *The Canadian Budgetary System*, p. 36.

CHAPTER XV

DOUBLE TAXATION

UNDER modern conditions of life a person may be a citizen of one State, own property and business in a second, and actually reside in a third State. The question, therefore, arises, which of these States should have the privilege of taxing the individual in question. Problems of this character, generally speaking, are comparatively recent in their origin, although there are some who maintain that complications like these arose even as far back as the days of Adam Smith. Indeed, it has been held that when Adam Smith laid down that "the subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities—that is, in proportion to the revenue which they respectively enjoy under the protection of the State," he was, amongst other things, referring to the case of persons having property in different countries.[1] Bastable points out that the concluding portions of the first canon of taxation imply a prohibition of double taxation. Whatever may have been Adam Smith's intention, it is undoubted that international complications relating to taxation had not then assumed such prominence as at the present time.

Conflicts between Tax-Jurisdictions.

Double taxation arises owing to the adoption of two fundamentally distinct bases of taxation by the taxing authorities, namely, those of origin of income and of the domicile or permanent residence of the recipient of such income. This problem of conflict between the laws relating to taxation in different States was considered by a small committee consisting of Sir Josiah Stamp, Professors Selig-

[1] Bastable: *Public Finance*, Chap. VII, para. 3 of Book III.

man, Einaudi and Bruins appointed by the Finance Committee of the League of Nations. In the course of their report the Committee point out that there are only four methods of avoiding international double taxation. They are:

(1) to exempt from taxation all incomes going abroad;
(2) to allow as deduction from the tax due any tax paid to foreign countries;
(3) to classify incomes into two categories, according as origin or domicile is the preponderating element, and then to tax the first category of incomes in the country of origin and the rest in the country of residence of the recipient;
(4) Lastly, the method of division of the tax. Under this method, as a result of agreements between countries, a portion of the tax is borne by the country of origin and a portion by the country of residence.

The first method is not likely to find favour with modern Governments handicapped by the eternal lack of pence. No State, particularly if its citizens are debtors in a preponderating degree in the world's money market, is likely to impose upon itself a self-denying ordinance of the character suggested in it. The second method is equally unacceptable, though for a different reason, for it places upon the creditor countries the whole burden of taxation imposed in the debtor country. The third method suffers from the defect that complications are likely to arise when the problem of classification of income is taken in hand. For all practical purposes the method of mutual agreement offers the only suitable solution.

It may at once be admitted that there are practical difficulties in the way of international agreements on questions of taxation, difficulties far more serious than those which are encountered in the case of tariff or commercial treaties between nations. The differences in the tax systems of two countries, in the method of arriving at taxable income, and in the pecuniary sacrifice of the contracting parties, make it difficult for two foreign Governments to come to an agreement likely to be acceptable to both.

Obstacles of this nature, though real, are likely to be less formidable in the case of countries bound together by ties of common political allegiance, whose economic interests require a free flow of capital from one part to another. Hence it is that this last method has been adopted to avoid double taxation within the British Empire. Before considering the details of the existing scheme it may be worth while to review historically the successive stages of development, which have finally culminated in the acceptance of the idea, that common political and economic interests of those resident in the British Empire justify a policy of mutual concessions on settled lines.

Double Taxation within the British Empire, 1860–93.

It is interesting to note that attention was drawn for the first time to the problem of double taxation within the British Empire as a result of the imposition of an income tax in India in 1860. In 1861 a petition was presented to the House of Commons by residents in the United Kingdom whose income was derived from India. They found for the first time that their income was subjected to taxation both in Great Britain and in India. On the 19th March, 1861, attention was drawn to this grievance in a motion before the House of Commons. It was suggested in the course of the debate that followed that one of two alternatives might be adopted. One proposal was to exempt from taxation in Great Britain all incomes which were subject to income tax in India and *vice versa*. The other alternative was somewhat similar to the third solution offered by the sub-committee appointed by the League of Nations. The proposal was to tax real property in the country of origin and personal property in the country of residence. Both the alternatives proved unacceptable at the time, as it was felt that Great Britain should not change her tax system simply because another country had found it necessary to impose an income tax.[1] The burden of double taxation was felt not only by individuals resident

[1] See Appendix 7 (*c*) to the *First Instalment of the Minutes of Evidence before the Royal Commission on the Income Tax*, 1920. See also memorial of the Civil Service of India regarding grievance as to retiring allowances. Cd. 230 of 1862.

in Great Britain, but also by companies registered there and carrying on business in India. Under the operation of the Indian Certificate Tax Act of 1868 all companies had the option of paying an annual composition tax of Rs.500 on each of their agencies or of being assessed at the rate of 1 per cent. of their declared dividend for the year. It was believed at the time that in the case of companies having their head offices in London and operating by means of agencies in India, the 1 per cent. rate was to be levied only on the dividend earned in India.[1] The companies were soon disillusioned, when the Government interpreted the clause as meaning that the tax was to be charged on the entire dividend, irrespective of whether the dividend was earned in India or abroad.[2] The Committee of the Bengal Chamber of Commerce recorded their emphatic protest against this decision under which the profits earned in one country were made tributary to the revenues of another, and referred to it as "a novel idiosyncracy in Political Economy." But their grievance relating to double taxation remained unredressed.

From 1893 onwards the problem assumed a different shape as the Dominions began to impose income tax, and agitation against double income tax began to grow louder and louder.

In 1896 the matter engaged the attention of the Royal Colonial Institute and a remonstrance was sent to the Chancellor of the Exchequer in England. As a result of this and other remonstrances the grievance was ventilated in the House of Commons, and in 1896 an amendment was moved to the Finance Act providing for relief against double taxation. The amendment ran as follows:

Protests against Double Taxation, 1893–1916.

"Provided that when the Commissioners are satisfied that in a British possession duty is payable in respect of any income accruing in such possession, they shall allow a sum equal to the amount actually paid as such duty to be deducted from the amount

[1] Letter of the Bengal Chamber of Commerce, dated the 18th April, 1868, to the Government of India.

[2] Reply of the Government of India, dated the 28th April, 1868, *Report of the Bengal Chamber of Commerce* for the half-year ending 30th April, 1868.

payable as income tax in respect of that income if received in the United Kingdom."

Nothing tangible resulted from this amendment.

The question was also debated in India in the Legislative Council. On the 3rd February, 1899, the Hon. Mr. Allan Arthur asked whether the Government would move the Secretary of State for India with a view to provide that income tax should not be levied in England on incomes on which Indian income tax had already been paid. On behalf of the Government Sir James Westland stated in reply that the Secretary of State would be communicated with. There is nothing on record to show what reply was received from the Secretary of State.

The matter was next taken up by the Fourth Congress of the Chambers of Commerce of the British Empire which met in London in June, 1900. This Congress passed a resolution drawing attention to the inequitable character of the laws in question. The resolution was in the following terms:

"That it is inequitable that income tax be levied in the United Kingdom on profits made in British Colonies and possessions upon which income tax has been paid in such Colonies and possessions, and that it is equally inequitable that income tax be paid in any British Colony or possession on profits made in the United Kingdom upon which income tax has been paid in the United Kingdom, and that representation be made to the Home and Colonial Governments urging the repeal of enactments imposing double income tax on British subjects."

After the passing of this resolution the attention of the Bengal Chamber of Commerce, Calcutta, was drawn to this matter early in 1902 by Mr. D. F. Mackenzie of the firm of Messrs. Mackneil & Co. The result of Mr. Mackenzie's action was that it was decided to send a memorial to the Viceroy on the subject. The memorialists, who belonged for the most part to the Bengal Chamber of Commerce and the Calcutta Trades Association, drew the attention of the Government of India to the resolution passed at the Conference of the Chambers of the British Empire, and took their stand on the principle that nowhere in the terri-

tories subject to H.M. the King-Emperor there should be double taxation in respect of the same income. They suggested that the principle which had already been embodied in section 20 of the British Finance Act, 1894, prohibiting double taxation with respect to death duties should be extended to income tax as well.[1] The memorial was in due course forwarded by the Government of India to His Majesty's Government in England with the observation that the matter was one on which public opinion in India felt strongly, and that it seemed desirable to remove every impediment to the free flow of English capital in India. The Lords Commissioners of His Majesty's Treasury did not see eye to eye with the Government of India on the subject and turned down the proposal. They refused to admit that any injustice was involved in taxing the same income twice, as owing to the circumstances of the case the recipients of these incomes were citizens of both the countries and required the protection of two Governments. Financial considerations also stood in the way of the relief asked for, as the amount of income enjoyed by the residents in the United Kingdom was comparatively large. If a policy of mutual concessions was adopted by the Colonies and dependencies on the one hand and United Kingdom on the other, the loss to the British Exchequer was likely to be much greater than the sacrifice which India and the Colonies would have been called upon to make. This loss to the British Exchequer would have to be made good by fresh taxation on the people of Great Britain. The analogy of concession in respect of death duties granted under section 20 of the Finance Act, 1894, was, in the opinion of the Lords Commissioners, not a valid one, as the Estate Duty was only an occasional tax levied on capital and not on income.[2]

The Government of the United Kingdom adopted the same attitude eight years later, when in 1911 the Imperial Conference discussed a resolution to abolish double taxation

[1] Memorial dated the 1st November, 1902, *Report of the Bengal Chamber of Commerce* for 1902, Vol. I, p. 58.

[2] Letter No. 6094, dated the 25th May, 1903, from the Lord Commissioners of His Majesty's Treasury.

within the Empire. The Prime Minister, while expressing sympathy with the resolution, declined to give up the revenue involved.

Partial Relief during 1916–20.

The hardship resulting from double taxation became much more acute in 1914, when under the Finance Act of that year the Government of the United Kingdom decided to extend the liability to income tax to unremitted incomes accruing abroad from stocks, shares, and rents. To this was added the further difficulty caused by the increase in the rate of income tax during the war. All these strongly pointed to the need for providing some relief even if it was partial, and in 1916 section 43 of the Finance Act provided a relief which was admittedly temporary and was " without prejudice to future consideration of the relative claims of the Exchequers of the United Kingdom and of the Dominions." Section 43 of the Finance Act, 1916, provided that where an individual had borne United Kingdom tax at more than 3*s*. 6*d*. in the £, and Dominion tax in respect of the same income, he should be refunded :

(*a*) such an amount as would reduce the United Kingdom income tax on that part of his income to 3*s*. 6*d*. in the £, or

(*b*) the amount of the Dominion tax on that part of his income, if that amount is smaller than the repayment under (*a*).

The relief provided by this section was in the nature of a makeshift, as smaller incomes did not benefit at all. In the case of incomes which did benefit, the maximum relief was only 1*s*. 6*d*. in the £, as the rate of the British income tax in 1916 was 5*s*. in the £. In 1918 the British rate was increased to 6*s*. in the £. The maximum relief which could be claimed in the United Kingdom in respect of double taxation was, therefore, raised to 2*s*. 6*d*. in the £.

Meanwhile the Imperial War Conference had met in 1917 and had passed a series of resolutions urging, among other things, the adoption of suitable steps immediately after the conclusion of the war with a view to remedy the existing unsatisfactory character of relief. The question was finally

lower of the two taxes (British and Indian) is given in India. Section 49 of the Indian Income Tax Act provides for this further relief. It runs as follows:

"If any person who has paid Indian income tax for any year on any part of his income proves to the satisfaction of the income tax officer that he has paid United Kingdom income tax for that year in respect of the same part of his income, and that the rate at which he was entitled to, and has obtained, relief under the provisions of section 27 of the Finance Act, 1920, is less than the Indian rate of tax charged in respect of that part of his income, he shall be entitled to a refund of a sum calculated on that part of his income at a rate equal to the difference between the Indian rate of tax and the rate at which he was entitled to, and obtained, relief, under that section: Provided that the rate at which the refund is to be given shall not exceed one-half of the Indian rate of tax."

Till the beginning of the year 1922 the Indian rates of income tax and super-tax combined were less than half the corresponding British rates all along the scale of income. There could, therefore, arise no claim for refund in India under section 49. The entire cost of relief fell upon the British Exchequer. With the raising of the rates in 1922 the Indian treasury was called upon in some cases to make the requisite refund to ensure that no person should pay in all at a rate of tax in excess of the higher of the two rates.

These rules relating to the avoidance of double taxation are working satisfactorily. There is, however, one matter of detail which may be mentioned. The Indian Income Tax Act provides that claims for refunds in India should be "made within one year from the last day of the year in which the tax was recovered." [1] But before claiming this relief in India an assessee must first obtain from the authorities of the United Kingdom the relief due, and then submit his claims for the balance of relief in India. He must also produce a certificate that he has in fact obtained relief from the English Treasury, and also proof of the rate of the relief. These formalities require time, and it often becomes difficult

[1] Section 50, Act XI of 1922.

for business men to produce the required proof within the allotted time. It is true that the income-tax authorities accept a formal notice within the sanctioned time as sufficient, even though not accompanied by all the required particulars, but it is much better that law and actual practice should coincide, rather than discretion be left to the authorities. The time limit should be suitably extended and the law modified accordingly.

Double Taxation in British India and in the Native States.

There is one other aspect of double taxation which requires more than a passing reference. Section 49 of the Indian Income Tax Act of 1922 provides for relief from double taxation as between India and Great Britain only. It does not afford any relief in other cases, such as may arise owing to a company having its head office in British India and branch offices in one of the numerous Native States of India. Some of these States have now imposed an income tax of their own, with the result that many companies are taxed in British India as well as in the Native States. A small concession was granted to these companies in 1915, when the Government of India laid down that in the case of such businesses income tax paid in a Native State should be deducted from the total income before assessing income tax in British India.[1] This action of the Government did not provide for that full measure of relief which business men wanted. An attempt was made to give this relief in 1922, when during the debates over the Indian income tax bill an amendment was moved providing that in all cases of double taxation of the same income in a Native State and in British India the assessee should be entitled to a refund not exceeding half of the British Indian rate of tax. The amendment, if carried, would have caused a considerable loss of revenue to the Indian treasury. For it would have amounted to an admission that wherever the same income was taxed twice, once by the Government of India and a second time by a Native State, the latter

[1] Letter of the Government of India, No. 1510 F, dated the 23rd October, 1915, in the *Report on the working of Income Tax in Bengal, during triennium ending 31st March, 1917.*

authority had the prior claim under all circumstances to any income tax upon that income. The entire cost of relief would then have fallen on the Indian treasury. That arrangement would have been exactly the reverse of that subsisting between Great Britain and India during 1920–1 under section 27 of the Finance Act of 1920. What the situation required was an arrangement under which the loss could be shared equally between the two taxing authorities. The Joint Committee of the Legislative Assembly and the Council of State on the income tax bill of 1922 had recommended that immediate steps should be taken to enter into negotiations with the Native States on the subject. On an assurance being given by the Government of India that they were prepared to carry out this recommendation, the amendment was withdrawn.

The Government of India have since then entered into negotiations with several Native States, and have granted relief under section 60 of the Income Tax Act, 1922. Section 60 runs as follows:

Relief Provided.

"The Governor-General in Council may by notification in the *Gazette* of India make an exemption, reduction in rate or other modification in respect of income tax in favour of any class of income or in regard to the whole or any part of the income of any class of persons."

In July, 1926, arrangements were in force for relief of double taxation with the following Native States:

Baroda, Travancore, Dhar, Patiala, Bhawalpur, Jind, Kapurthala, Loharu, Sachin, Akalkot, Phaltan, Benares, Bastar, Kanker, Raigarh, Jashpur, Sarangar, Makrai, Kawardha, Korea, Khairagarh, Nandgaon, Chhuikhadan, and Mayurbhanj.

Under existing arrangement an assessee is entitled to recover the lesser of the two taxes, and the cost of relief is shared equally between the two taxing authorities.[1] The Government of India Notification dated the 1st July, 1926, provides that the assessee should be given a refund "at a rate equal to half the State rate of tax, provided that the

[1] *Report of the Taxation Inquiry Committee*, para. 255.

rate at which the refund shall be given shall not exceed one-half the Indian rate of tax." [1]

[1] *Income Tax Manual* (1925), p. 145*b*. An illustration may be given here of the type of income tax prevalent in the Native States. In Mysore the tax is imposed on all income from whatever source derived, arising or received in the State or deemed to arise or be received in the State. Agricultural income and income of local authorities are exempt.

The rates of tax in force during 1927–8 were as follows:

A. Individuals, unregistered firms and Hindu undivided families.

Total Income.		Rate per Rupee on Taxable Income.	
Not less than	But less than	Annas.	Pies.
Rs.	Rs.		
—	2,400	Nil	Nil
2,400	9,000	—	3
9,000	25,000	—	4½
25,000	40,000	—	6
40,000	50,000	—	9
50,000	—	1	—

B. Companies and registered firms paid at the rate of one anna in the rupee.

In addition to this tax, super-tax was payable at the rate of 1 anna in the rupee by individuals, unregistered firms and companies on the amount by which the total income exceeded Rs. 50,000 a year. In the case of Hindu undivided families the first 75,000 rupees was exempt —see *Income Taxes in the British Dominions*, 1928 (H.M. Stationery Office), pp. 212–21.

CHAPTER XVI

THE ADMINISTRATIVE MACHINERY

It has been remarked that conditions of administration are no less important than the rate of taxation in determining the success or failure of income tax.[1] Even the most equitable income tax becomes unfair in its incidence, if the machinery for its enforcement is not adequate to prevent evasion. It is unfortunate that this important aspect should have been ignored in India in the early days of income-tax administration, and in accordance with the policy then prevailing the Collector Magistrate became the local head of the administration in all its branches, including the collection of income tax.

Income Tax administered by Land Revenue Officials.

Ever since the first introduction of income tax in India until very recent times, the income-tax department had been treated as subsidiary to the department of land revenue. Even as late as in 1886, when it became apparent that an income tax in some form or other was needed to maintain equilibrium in the budget, no specialized staff was created charged with the specific duty of looking after income-tax work in the Provinces. In every Province, except to a small extent in Bengal, the income tax was administered by the Collector of land revenue aided by his subordinate officers. The designation of these subordinate officers varied from Province to Province. For instance, in the rural areas of the Bombay Presidency, assessments were made by persons who were styled *Mamlatdars* or *Mahalkaris.*[2] In the

[1] See Bullock: *Selected Readings in Public Finance*, p. 482.

[2] *Report on the Administration of Income Tax in the Bombay Presidency*, 1886–7.

towns the *Huzur* Deputy Collectors were entrusted with the work. In the North-Western Provinces (subsequently renamed the United Provinces of Agra and Oudh) the subordinate officers were styled *Tahshildars*. In the Province of Burma the income tax assessment roll was prepared by Subdivisional Officers or Township Officers with the aid of *Taik Thugyis* [1] and village or ward headmen.[2] The latter were remunerated by a fee of 3 per cent. on their collections.

Specialized Subordinate Staff in Bengal.

The absence in Bengal of a village land revenue establishment, such as was to be found in other Provinces of India, necessitated the creation of a more or less specialized subordinate staff for the work of income-tax assessment. In 1886 the districts in Bengal were divided into three classes according to their importance. One Assessor was appointed for a period of twelve months in every district. In addition, districts of the first class in which the work of assessment was comparatively heavy, were given two Assessors, and districts of the second class one Assessor for a period of six months. Calcutta was fortunate in possessing a self-contained staff from the very beginning. The town of Calcutta with suburbs and the town of Howrah were constituted into a separate district, and placed under a Collector who was assisted by a varying number of Deputy Collectors and Assessors. In other districts the Collector of land revenue exercised general supervision over the Deputy Collectors who were assisted by the Assessors.

It might seem at first sight that the arrangement thus adopted in Bengal, although not an ideal one, was at any rate economical, having regard to the nature and amount of income-tax work that had to be done in those days. As a matter of fact the short-sighted policy of economy was carried farther than was necessary. For the Assessor of income tax was an Inspector of Excise as well, and in this last capacity had to look after the collection of revenue from the sale of exciseable intoxicants.[3] It is true that on

[1] *Taik Thugyis* are circle officers who prepare the land revenue assessment rolls and collect the land revenue.

[2] *Report on the Administration of Income Tax in Burma*, 1898–9.

[3] Government of Bengal Order No. 1375, dated the 26th March, 1887.

the appointment of a Commissioner of Excise in Bengal in 1890, a separation was carried out between income tax and excise establishments,[1] but this separation was applicable only to the Assessors. So far as the Deputy Collectors were concerned, they continued to perform both excise and income-tax work till the years 1915–17, when the formation of a close excise service led to a change in the system.[2] To add to the burden of the poor Deputy Collector, he was sometimes given in addition treasury work and criminal judicial work. The work of the income-tax department did not materially suffer when the Deputy Collector combined excise and income-tax work, as both necessitated touring in the interior of the district. But if to these were superimposed revenue and judicial work, which necessitated prolonged stay at head-quarters, it became difficult for even the able and energetic amongst them to attend to these multifarious duties.

What was true of Bengal was more or less true of other Provinces. The land revenue officers burdened with miscellaneous duties had rarely time completely to master the provisions of the Income Tax Acts or to scrutinize the accounts of the assessees. The result was that the assessment of small up-country assessees who kept no accounts, and about whom the assessing officer knew nothing personally, was a matter of guesswork based often on rumours and hearsay.[3] It was, therefore, futile to expect a satisfactory increase in the receipts from income tax, even when the receipts from other sources of revenue suggested a period of prosperity. To quote only one instance, the Government of Madras noticed during 1913–14 that the revenue from income tax showed little development, such as might be expected from a consideration of the usual tests of prosperity, and called for a report from the Board of Revenue. The Board admitted the existence of this unsatisfactory state of affairs and suggested as a remedy, amongst other things, the employment of a staff of trained accountants to

[1] Government of Bengal Order dated the 4th December, 1889.

[2] *Report on the Working of Income Tax in Bengal*, triennium 1915–17.

[3] *Report on the Administration of Income Tax in the Presidency of Madras*, 1923–4.

scrutinize the accounts placed before the assessing officers. The Government of Madras sanctioned as an experimental measure the appointment of several accountants in Madras, Madura and Ramnad districts. Similar experiments were tried more or less in all Provinces, particularly in large industrial areas during 1912–17.[1]

But the real impetus to the appointment of a specialized staff came with the passing of the Income Tax Act of 1918.

The Income Tax Act of 1918 and the Employment of a Specialized Staff.

The Act of 1918 was a far more complicated measure than the one which it superseded, requiring for its successful administration a knowledge of the general principles of accounting and also of the various systems of book-keeping current in the different Provinces. Such technical knowledge the ordinary district staff employed mainly in land revenue work was hardly expected to possess. The growing complexity of work, due partly to the increase of rates that had taken place during 1916–17, and the consequent increased attention that the assessees themselves bestowed on the preparation of their accounts also necessitated a correspondingly increased attention from the revenue authorities. This attention the overworked executive staff could not bestow. Need was, therefore, felt for the appointment of a staff devoted solely to income-tax work. The specialization in the staff took two different forms. In the first place in the Presidency towns the Government tried to secure the services of experts as far as practicable. In the second place in districts and towns the aim was to employ a special establishment not so technically trained as in the Presidency towns, but a special revenue establishment solely devoted to income-tax work. Thus in the Madras Presidency the immediate effect of the passing of the Act of 1918 was that the existing staff of Inspectors and Accountants in the Madras city was strengthened, and special Inspectors were appointed in select localities. The administration of the income-tax

[1] *Report on the working of Income Tax, Bombay*, triennium ending March, 1917, and also of the previous triennium ; also of Bengal, triennium ending March, 1917.

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department was transferred to one of the Commissioners of Land Revenue who was eventually relieved of land revenue work.[1] In the United Provinces an Assistant Commissioner was appointed in 1918. In the same year selected Deputy Collectors were appointed in most districts as whole-time income-tax officers. A whole-time Collector of Income Tax, who was a Chartered Accountant, was appointed for Rangoon in November, 1918, with highly satisfactory financial results. The receipts from income tax rose from Rs.32·1 lakhs in 1917–18 to Rs.50 lakhs in 1918–19 and to Rs.69·3 lakhs in 1919–20. A substantial increase of revenue was expected in any case, in view of the post-war rise of prices that had taken place. But what was most significant was that the increase in the revenue was confined to Rangoon, while the receipts from the districts remained stationary. The following table illustrates the receipts from Rangoon and those from other districts during 1917–18 to 1919–20.[2]

Year.	Receipts from Rangoon in Rupees.	Receipts from Districts in Rupees.
1917–18	3,211,616	858,009
1918–19	5,000,694	920,068
1919–20	6,934,904	821,797

It was estimated that in some of the cities of the Punjab the effect of the establishment of a specialized agency was an increase in the yield by as much as 49 per cent. During 1919–20 the Calcutta income-tax office was strengthened in several ways, among others by the temporary appointment of two additional income-tax assessors, and of one additional examiner of *Marwari* accounts. The Assessors were now divided into two classes, viz., those who were mainly employed in outdoor work in ascertaining names, addresses and other information of persons liable to income

[1] *Vide Report on the Working of Income Tax, Madras,* triennium ending March, 1920.
[2] *Report on the Working of Income Tax, Burma,* triennium 1917–20.

tax, and those doing office work.[1] In the Bombay Presidency, also, the income-tax establishment was suitably strengthened.[2]

Centralization under the Reforms.

The increased employment of a specialized staff, which may be said to have commenced with the passing of the Income Tax Act of 1918, was continued in the next few years. In the meantime the Montagu-Chelmsford Reforms had been inaugurated, and, as one of the fundamental principles of the constitutional reforms was that there should be a clean-cut division between the functions and resources of the Central and those of the Provincial Governments, it became necessary to relieve the latter of their task of administering the income-tax department. Income tax became a central source of revenue and the Income Tax Act of 1922 created a Board of Inland Revenue under the Government of India. This Board was specifically entrusted with the care and management of income tax work. On the constitution of the Central Board of Revenue early in 1924, the Board of Inland Revenue ceased to function.[3] The Central Board administers, in addition to income tax, other central sources of revenue such as customs, salt, opium, and to a certain extent excise and stamps which are at present mainly Provincial sources. It might thus appear that the centralization of administration in the department of income tax was the direct outcome of the political changes. But there is one consideration which must be borne in mind in this connection. The process of centralization could not have been long delayed in any case. As we have seen, the latitude given to the Provinces before 1922 had resulted in diversity of practice in several matters causing inconvenience to traders and business men. The political reforms merely hastened the adoption of a step which was inevitable in the interest of uniformity.[4]

[1] *Report on the Administration of Income Tax in Bengal*, 1919–20.

[2] *Report on the Working of Income Tax, Bombay Presidency*, triennium ending March, 1920.

[3] Act IV of 1924.

[4] See in this connection the speeches of Sir Basil Blackett and of Mr. Arthur Moore in the *Indian Legislative Assembly* on the 13th March, 1928.

The Act of 1922, besides centralizing the administration of income tax, laid the foundations for the employment of a whole-time staff of officers whose functions are in many respects analogous to those of Inspectors of Taxes in Great Britain. It was contemplated that the staff should consist of experts of high standing, trained in accountancy, whose remuneration should be such as to attract men of this type. The All-India Central Committee of officials and non-officials convened in July, 1921, to make recommendations regarding the income tax bill of 1922 had emphasized the need for technical training on the part of these officers. They remarked: "Accountancy should be one of the foundations of training for the whole service." To realize vividly the progress made with regard to the standard of attainments needed of an income-tax officer, it is necessary to carry our mind back into the early 'nineties, when a knowledge of the vernacular numerals and of the languages in which the Indian accounts were kept, was a sufficient passport to a fairly important and responsible position in the income-tax department. When the Bengal Board of Revenue laid down in 1895–6 that "the assessors should gradually learn not only the numerals, but also the languages in which accounts are kept," it perhaps felt that the standard was exacting enough. But the progress made in the intervening years had made such a standard hopelessly antiquated. Under the Acts of 1886 and 1918 the powers connected with income-tax administration were exercised by the Chief Revenue Authority, which was the Board of Revenue, the Commissioner of a Division who was the appellate authority, and the Collector of land revenue who was the assessing officer. At the present time under the Act of 1922 the head of the income tax department of a Province is the Commissioner of Income Tax, the appellate authority is designated as the Assistant Commissioner of Income Tax, while the actual work of assessment is performed by a technically trained body of men known as Income Tax Officers.

The Employment of Experts.

The Central Board of Revenue is appointed by the Governor-General in Council. This body consists at present of

two members and is assisted by a Secretary and subordinate staff. The Commissioner of Income Tax is also appointed by the Governor-General in Council.[1] The rest of the Provincial staff are appointed and dismissed by the Commissioner subject to the control of the Governor-General in Council. This control is an indirect one, as it is exercised through the agency of the Governor in Council of the respective Provinces.[2]

As the All-India Committee on the income tax bill of 1922 had recommended that the separate whole-time agency outlined above should consist only of technically trained men, the staff could not be recruited all at once in sufficient numbers to enable the old agency to be supplanted *en bloc* by the new. Accordingly, the transfer from the department of land revenue to the newly created department was effected gradually. By the end of 1923–4 the new department had completely supplanted the old in the Punjab, North-West Frontier Provinces, Behar and Orissa, the Central Provinces and the United Provinces.[3] By March, 1927, the entire work had been taken over by the special income-tax staff, except in nine districts in Upper Burma and four districts in Lower Burma.[4]

The only Province in which the work still continues to be performed largely by the land revenue department is Assam, where the Provincial Government administer the tax in return for a commission of 3 per cent. on the collections, other than those on Government salaries and interest on securities. A staff of two whole-time Income Tax Officers is maintained out of this commission, the duty of these officers being to assess the bigger concerns in the Province.[5]

In addition to the Provincial staff described above, an all-India staff has been appointed, posted mainly at the head-quarters of several railways and those of certain military and civil audit offices. The duty of this Central staff

[1] Section 5 (3) of Act XI of 1922, as amended by section 2 of Act XVI of 1928.

[2] *Income Tax Manual*, Vol. I, p. 91.

[3] *Report of the Central Board of Revenue*, 1923–4.

[4] *Report of the Central Board of Revenue*, 1926–7.

[5] *Report of the Central Board of Revenue*, 1925–6. This arrangement with Assam terminates on the 31st March, 1929.

is to assess the officers who are liable to transfer from one Province to another, and the employees of the railways which pass through more than one Province.[1] The expenditure incurred in the maintenance of the income-tax staff during 1913–14 was Rs.469,000. During 1921–2 it amounted to Rs.2,820,000. In 1922–3 it rose to Rs.4,701,000. It will be noticed that the expenditure increased tenfold during a period of nine years. But a part of this increase is more apparent than real. As the collection of income tax was in the hands of land revenue officers before the appointment of a whole-time staff, the only item debited to income-tax expenditure in the figure for 1913–14 was the expenditure on the special whole-time staff employed in the Presidency and large industrial towns. As income tax was a divided head of revenue before the Reforms, both the receipts and the cost of collection were shared between the Central and the Provincial Governments. We have already seen [2] that from 1921–2 the Provincial Governments received an assignment of 3 pies in the rupee of every additional rupee of income assessed in the respective Provinces in excess of the amount assessed in 1920–1. Under this arrangement the Provinces had to pay 25 per cent. of the cost of collection. Under the new Devolution Rules framed in 1922–3 the Central Government undertook to pay the whole cost of collection which represented 2 per cent. of the receipts during 1922–3.[3]

The Cost of the New Agency.

It is argued in some quarters that the new staff thus appointed, however efficient from the technical point of view, is bound to feel a great handicap in its work, as it has not got at its disposal the large intelligence staff in the shape of village officers who used to help the Collector under the old system. It appears that these difficulties are exaggerated, for it is regarded as one of the most important duties of the staff to discover new assessees. The department relies for the discovery of new assessees not on the information supplied by ill-paid village officers, but on the vigilance and

[1] *Income Tax Manual*, Vol. I, pp. 91–2. [2] See Chapter XIV.
[3] *Report of the Inchcape Committee*, pp. 218–19.

honesty of the staff. During 1925–6 the department discovered no fewer than 1,025 new assessees in Calcutta alone, and over 2,500 in the Punjab.[1] It is also collecting valuable information regarding property owners and also other information likely to be useful in its work. There is, therefore, no reason to apprehend that the new staff would compare unfavourably with the old in this respect. On the other hand, the newly created agency has several positive merits which the old department lacked. In the first place, officers recruited under the new system are better conversant with the intricacies of commercial accounts and business methods than the old revenue officials "to whom income-tax work was merely one item, usually a most distasteful one, in the duties of a busy day." In the second place, the new staff is likely to inspire confidence to a greater extent than the old. Under the old system, the action of the district staff in enhancing an assessment was liable to be misconstrued. It was sometimes complained that the executive officers were not averse to using their taxing powers to bring pressure to bear upon assessees who had made themselves odious to the district staff for some reason or other. The separation effected between the executive and revenue functions has now removed any cause for undesirable impressions like these, however erroneous or unfounded they may have been. It must also be remembered in this connection that an assessment to be accepted by the people must be understood by them, particularly in view of the increase in rates that has taken place in recent years. The revenue authorities must be prepared to devote their time ungrudgingly to explain to the tax-payers the methods followed in arriving at assessments. Such a procedure removes friction and renders administration of the tax easier in future. In the past, however, it was often felt that the revenue authorities did not bestow that amount of attention which the assessees had a right to expect.

The Merits of the Existing System.

The duties of the staff brought into existence by the Act of 1922 are laid down with sufficient clearness in the Act

[1] *Report of the Central Board of Revenue,* 1925–6.

and is answerable to the Chancellor of the Exchequer in securing the execution of the Income Tax Acts. The Board has under its control scattered through the country a highly efficient body of permanent civil servants known by the name of Inspector of Taxes. These are mostly University-trained men and are appointed on the result of competitive examinations. They are responsible to the Board of Inland Revenue for safeguarding the legitimate interests of the Crown in all matters relating to income tax.

The Administrative Machinery in Great Britain.

Interposed between the Board of Inland Revenue and the Inspectors of Taxes are unpaid local assessors known as General Commissioners and Additional Commissioners. This non-official machinery is based on that adopted in connection with the land tax, which had existed for more than a century at the time when income tax came to be introduced in Great Britain. Under the Land Tax Acts the county was made the administrative unit and Commissioners were nominated by the Acts for each such unit. The Commissioners so appointed were required to nominate from among themselves General Commissioners (abbreviation for Commissioners for the general purposes of the income tax) for each division into which the counties had long been divided. It was the duty of the General Commissioners to put the Income Tax Acts into force as regards each parish within their division.[1] They appointed assessors, made assessments, heard appeals, and forwarded the amount of tax collected to the Treasury. The representative of the Crown had very little power in these matters in the early days of income-tax administration. In those days trade and industry were largely centred in the parish or locality, and the idea was to ensure the assessment and collection of the tax with the minimum of interference by the Exchequer.[2] To-day the conditions of business have changed. Modern complexities render it imperative that

[1] See the evidence of Sir Thomas Collins in the *First Instalment of the Minutes of Evidence before the Royal Commission on the Income Tax*, 1920, paras. 263–306.

[2] Appendix IV, *First Instalment of the Minutes of Evidence before the Royal Commission on the Income Tax*, 1920.

the bulk of the work should be done by technically trained men able to devote their whole time and energy to the task. It is also necessary to ensure that information obtained in any part of the country should be made readily available for use in another part. These circumstances have contributed to transform the scheme of administration originally contemplated in Great Britain. Under modern conditions much of the work that theoretically belongs to the local Commissioners is done by the Inspector of Taxes. But with the partiality for old institutions and traditions so characteristic of the British race General Commissioners have been retained down to the present day. Their main function now is to hear appeals from assessments. It is, however, well known that the great majority of appellants settle their disputes with the Inspector of Taxes, and the agreement arrived at with these officers merely receives the formal sanction of the Commissioners. The Royal Commission on the Income Tax recognized that the institution of unpaid Commissioners was in many respects an antiquated one. But they refused to recommend its abolition. They remarked :

> . . . " the tax-payer . . . often looks upon the General Commissioners as a natural safeguard interposed between himself and the revenue authorities. We believe also that the General Commissioners by the exercise of local knowledge and common-sense judgment prove on the whole a satisfactory tribunal." [1]

The Additional Commissioners are appointed by the General Commissioners and are charged with the duty of making assessments under Schedule D, which relates to income from commercial, industrial and professional activities. Any person who has been assessed by the Additional Commissioners may elect to appeal either to the General Commissioners or to the Special Commissioners (shortened form of Commissioners for the special purposes of the Income Tax Acts). The latter are whole-time paid officials appointed by the Treasury to perform certain definite duties specially assigned to them. Among the more important duties assigned to the Special Commissioners are the hearing of

[1] *Report of the Royal Commission on the Income Tax*, 1920, para. 344.

appeals relating to Schedule D assessments, and the making of original assessment of income under the same Schedule on the request of any tax-payer who prefers not to be assessed by the Additional Commissioners. They are also responsible for the assessment and collection of super-tax and the assessment of the railway companies in the United Kingdom.

The description of machinery for the administration of income tax in Great Britain and in India outlined above reveals two very striking dissimilarities. In Great Britain the combination of the amateur and the expert, as illustrated in the employment of the services of the unpaid local commissioners and of the permanent civil servants, secures the maximum possible revenue, while safeguarding at the same time the interests of the tax-payers. In India there is no competent body of persons possessing local knowledge to aid the Income Tax Officer, who is liable to frequent transfer from district to district. We have seen in a previous chapter [1] that the use of non-official agency was found to be helpful in one Province at any rate, where it was given a prolonged trial. In the light of the experience gained in that Province a beginning should be made in establishing non-official appellate bodies in populous and industrial centres, where there would be no difficulty in securing the services of men able and willing to aid the income-tax authorities. A machinery of this kind would go a long way towards securing that harmony between the members of the public and the revenue authorities without which no income tax can be smoothly and efficiently administered.[2]

Another feature of the British income-tax administration which differentiates it from the Indian is the special treatment of super-tax. In Great Britain the super-tax is assessed and collected by the Special Commissioners who consist partly of experienced Inland Revenue officials and partly of men with legal training. The main object of the appointment of Special Commissioners of Income Tax is to afford

[1] See Chapter X.

[2] It may be mentioned in this connection that speaking in the *Indian Legislative Assembly* on the 13th March, 1928, Sir Basil Blackett referred, among other things, to the need for " more touch between the members of the public and the income-tax authorities."

business men the means of avoiding the disclosure of their profits to their neighbours. In India the income tax and super-tax are treated as one, both being assessed by the same official. The difficulty connected with the disclosure of business profits does not, therefore, arise at present. If at any time in the future non-official appellate bodies are set up, the use of this agency might be made optional at the instance of the assessee.

CHAPTER XVII

CONCLUSION

THE most striking feature of the evolution of the Indian income tax, as described in the foregoing pages, is the remarkable transformation in public opinion that has taken place regarding it. It was believed at the outset even by experienced British administrators, that any form of direct taxation was unsuited to an Oriental people and that the inquisitorial nature of the income tax rendered it specially repugnant to the people of India. It was held, further, that income tax was demoralizing both to the officers assessing and to the people assessed, and that from the political standpoint its imposition was a mistake because of its tendency to weaken the influence of the district officers by promoting distrust among those with whom they should live in constant and intimate intercourse. The tax has now been in existence continuously for over forty years. The causes which used to produce irritation and discontent among the tax-payers have now been remedied, and to-day there is nothing to show that there is any special resentment against it any more than against other taxes. Indeed, it is possible to maintain that the enlightened section of the public now realize that, if it is an evil, it is a necessary one, and that what is needed is not the abolition of the tax but its strict enforcement, so that the incidence may be fair as between different classes and individuals. Nor is there anything to suggest that from the moral and political standpoints its consequence has been at all harmful, as many of the British administrators apprehended it would be.

The growing complexity of modern business has necessarily made the Indian income tax of to-day a more compli-

cated instrument than it used to be in the seventies and the eighties of the last century. But what the tax has lost in simplicity it has gained in equity, due particularly to the continued efforts of the last ten years to remove inequalities in incidence and to adjust the burden according to the relative capacities of different classes of tax-payers. We have seen that in these efforts at reform reliance has been placed to an increasing extent on British income-tax practice. The most recent example of this tendency is to be found in the measure which was referred to a Select Committee of the Indian Legislative Assembly in February, 1928. This bill is largely modelled on the provisions of the United Kingdom on the subject, and is designed to prevent the evasion of the super-tax by the formation of what are known as "one-man companies." In the course of the preceding pages other features of the British income-tax law are examined, and it is suggested that some of these might be adopted in India with little or no loss of revenue.

The problem of income-tax administration which is likely to come to the forefront is the need for improving the yield of the tax, in view of the important part which it will be called upon to play in the near future. During and after the war the tax has been used to an increasing extent for bridging the gulf between expenditure and revenue. It is emphasized in the foregoing chapters, on the basis of a comparative study of British and Indian conditions, that the existing rates of Indian income tax may be increased still further, so far as incomes higher up the scale are concerned, without the apprehension of any injurious effect on industry and initiative. The problem of the taxation of agricultural income is also examined from the historical standpoint, and it is urged that there is no reason to believe that the administrative difficulties, referred to by the Indian Taxation Inquiry Committee, are greater to-day than they were in the last half of the nineteenth century.

But while with the advance of democratic institutions fresh sources of revenue must necessarily be tapped, unceasing efforts should simultaneously be made to stop all existing loopholes for fraud and evasion. Nothing is more calculated

to alienate public opinion than the belief that the income tax is unequal in its incidence and that it operates as a tax on honesty. It is suggested in the course of this study that, by suitable modifications in the existing law and practice the yield of the tax could be increased without imposing hardship on the honest tax-payers. At the same time stress is laid on the fact that while legal and administrative rules are useful in their own way for preventing leakage of revenue, they become more effective if they are backed by a healthy and powerful public opinion. The co-operation of all right-thinking citizens is, therefore, needed in the difficult task that lies before the revenue authorities.

APPENDIX A

STATEMENT SHOWING THE NUMBER OF PERSONS ASSESSED AND AMOUNTS REALIZED UNDER ACT XXXII, 1860, EXCLUSIVE OF DEDUCTIONS FROM THE SALARIES OF GOVERNMENT SERVANTS (*Vide* APPENDIX 20, SELECT COMMITTEE ON EAST INDIAN AFFAIRS, 1872)

	1860–1.		1861–2.		1862–3.	
	No.	Rs.	No.	Rs.	No.	Rs.
Bengal . .	276,482	6,374,741	278,482	5,791,963	72,544	4,565,267
Madras . .	98,461	1,252,827	139,529	1,672,486	85,029	1,352,666
Bombay .	212,262	3,196,237	218,968	3,410,290	43,341	3,292,066
N.W.P. . .	183,577	3,269,950	200,493	3,243,514	41,055	2,271,263
The Punjab	(*b*)	401,911	(*c*) 76,034	703,741	(*c*) 53,453	434,364
Oudh . .	(*d*) 26,735	280,298	44,238	346,433	3,963	395,285
Brit. Burma	(*e*) 19,391	234,758	33,102	234,964	3,355	131,512
C.P. . .	(*f*) 25,606	228,003	(*f*) 26,192	337,680	5,660	265,305
	842,514	15,238,725	1,017,038	15,741,071	308,400	12,707,728

), (*c*), (*d*), (*e*), (*f*).—See Notes on opposite page.

APPENDIX A—*continued.*

	1863-4.		1864-5.		Total.	
	No.	Rs.	No.	Rs.	No.	Rs.
Bengal . .	69,140	3,249,514	64,210	3,033,201	760,858	23,014,686
Madras . .	39,606	897,288	37,552	861,496	400,177	6,036,763
Bombay .	45,288	2,788,451	47,400	3,235,810	567,259	15,922,854
N.W.P. . .	39,905	1,660,029	38,847	1,591,453	503,877	12,036,209
The Punjab	13,621	367,717	(c) 24,514	413,824	(b) 167,622	2,321,557
Oudh . .	1,607	257,241	1,539	234,921	78,082	1,514,178
Brit. Burma	2,179	99,407	3,172	87,102	61,199	787,743
C.P. . .	(g) 5,660	187,098	(g) 5,660	365,073	68,778	1,383,159
	217,006	9,506,745	222,894	9,822,880	2,607,852	63,017,149

(*b*) Not given by the Punjab Government.

(*c*) Apparently includes Government servants. The Local Governments do not show the two classes separately.

(*d*) The number of persons assessed is not given for three districts in Oudh: the records of two districts appertaining to I.T. assessment under Act XXXII of 1860 were destroyed by white ants, and those of another were either sold or destroyed in 1865 as old and useless records.

(*e*) In some districts in British Burma collection for certain years cannot be ascertained.

(*f*) The figures are not accurate as they include double and triple enumeration of the same person when assessed under more than one schedule.

(*g*) Information as to number of persons assessed in 1863-4, 1864-5 is wanting.

APPENDIX B

STATEMENT SHOWING THE NUMBER OF PERSONS ASSESSED AND THE AMOUNTS REALIZED UNDER ACTS XXI AND XXVII OF 1867, EXCLUSIVE OF DEDUCTIONS FROM THE SALARIES OF GOVERNMENT SERVANTS FOR THE YEAR 1867-8

	Profits Rs.25,000 and up. Rate of Tax—Rs.500.		Profits Rs.10,000 and less than 25,000. Tax—Rs.200.		Rs.5,000 and less than 10,000. Tax—Rs.100.		Rs.1,000 and less than 5,000. Tax—Rs.20.		Rs.500 and less than 1,000. Tax—Rs.10.		Rs.200 and less than 500 Tax—Rs.4.		TOTAL.	
	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.
Bengal . . .	404	238,339	931	168,196	2,486	224,138	14,311	255,508	25,095	230,017	150,873	585,099	194,100	1,701,297
Madras . . .	35	20,012	160	28,297	720	65,980	5,525	101,210	15,613	149,467	94,942	376,080	116,995	741,046
Bombay . .	19	11,000	90	18,000	1,387	279,118	14,055	309,399	30,413	245,031	135,681	541,816	181,645	1,404,364
N.W.P. . . .	79	39,000	275	52,280	951	91,460	8,023	157,918	18,551	181,899	101,509	397,772	129,388	920,329
The Punjab .	10	5,000	39	7,800	221	22,120	2,504	50,078	7,992	79,971	59,482	238,042	70,248	403,011
Oudh . . .	1	500	21	4,200	87	8,700	737	14,740	1,721	17,210	14,563	58,252	17,130	103,602
British Burma .	10	5,161	27	3,377	321	6,531	946	16,548	5,905	50,632	13,707	45,166	20,916	127,415
Central Provinces.	Exempted from licence tax, being subject to Pandhari tax under Act XIV of 1867. See Financial Notification 1897 of 5th April, 1867.													
	558	319,012	1,543	282,150	6,173	698,047	46,101	905,401	105,290	954,227	570,757	2,242,227	730,422	5,401,064

APPENDIX C

STATEMENT SHOWING THE NUMBER OF PERSONS ASSESSED AND THE AMOUNTS REALIZED, EXCLUSIVE OF CONTRIBUTIONS FROM THE SALARIES OF GOVERNMENT SERVANTS DURING 1868–9 UNDER THE CERTIFICATE TAX ACT

	Class I. Profits 4 lakhs up. Tax—Rs.6,400.		Class II. Profits 2 lakhs, less than 4 lakhs. Tax—Rs.3,200.		Class III. Profits 1 lakh, less than 2 lakhs. Tax—Rs.1,600.		Class IV. Profits Rs.50,000, less than 1 lakh. Tax—Rs.800.		Class V. Profits Rs.25,000, less than 50,000. Tax—Rs.400.		Class VI. Profits Rs.15,000, less 25,000. Tax—Rs.160.	
	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.
Bengal	3	19,200	6	19,200	35	56,000	99	79,200	261	104,400	695	111,120
Madras	—	—	1	3,200	4	6,400	8	4,800	50	19,102	203	31,175
Bombay . . .	4	2,000	2	242	59	141,818	2	1,600	674	189,826	116	18,619
N.W.P. . . .	—	—	1	3,200	5	8,000	12	9,600	62	24,620	245	38,312
The Punjab . .	—	—	—	—	—	—	1	800	13	5,200	36	5,760
Oudh	—	—	—	—	—	—	—	—	5	2,000	25	4,000
British Burma .	7	6,900	8	3,525	41	2,320	191	7,042	12	4,136	30	4,645
C.P.	—	—	—	—	—	—	9	7,200	14	4,955	74	10,582
	14	28,100	18	29,367	144	214,538	322	110,242	1,091	354,239	1,424	224,213

APPENDIX C—*continued.*

	Class VII. Profit Rs.5,000, less than 10,000. Tax—Rs.80.		Class VIII. Profits Rs.2,500, less than 5,000. Tax—Rs.40.		Class IX. Profits Rs.1,000, less than 2,500. Tax—Rs.16.		Class X. Profits Rs.500, less than 1,000. Tax—Rs.8		Total.	
	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.
Bengal . . .	1,485	118,580	3,844	153,620	14,023	224,240	46,940	375,046	67,391	1,260,606
Madras . . .	635	48,133	1,875	70,622	6,695	103,956	24,124	190,104	33,595	477,492
Bombay . . .	523	41,539	7,870	252,061	8,059	128,856	41,107	327,496	58,416	1,104,057
N.W.P. . . .	659	51,734	1,733	68,623	6,851	109,224	24,726	195,041	34,294	508,354
The Punjab . .	151	12,080	562	22,480	3,068	49,088	13,907	111,250	17,738	206,658
Oudh	70	5,292	222	9,105	777	12,751	2,295	18,600	3,394	51,748
British Burma .	50	3,642	523	15,848	838	13,521	4,207	25,827	5,907	87,406
C.P.	140	9,869	456	17,031	1,457	22,416	3,369	26,164	5,519	98,217
	3,713	290,869	17,085	609,390	41,768	664,052	160,675	1,269,528	226,254	3,794,538

APPENDIX D

STATEMENT SHOWING THE NUMBER OF PERSONS ASSESSED AND THE AMOUNTS REALIZED DURING 1869–70, EXCLUSIVE OF DEDUCTIONS FROM SALARIES OF GOVERNMENT SERVANTS

	Class I. Income Rs.500, less than 1,000.		Class II. Incomes Rs.1,000, less than 2,000.		Class III. Incomes Rs.2,000, less than 10,000.		Class IV. Rs.10,000, less than 1 lakh.		Class V. 1 lakh rupees and upwards.		Total.	
	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.	No.	Amt. Rs.
Bengal . . .	142,947	1,335,392	26,200	502,919	16,691	890,949	2,508	864,945	180	735,497	188,526	4,329,702
Madras . . .	46,039	394,859	9,398	169,138	4,820	215,008	415	109,809	22	128,937	60,694	1,017,751
Bombay . . .	79,371	585,434	37,127	413,659	14,749	532,570	1,456	356,187	208	366,187	132,911	2,254,037
N.W.P. . . .	54,143	487,900	12,359	240,785	7,107	362,031	838	237,060	21	36,137	74,468	1,363,913
The Punjab . .	25,229	254,908	5,280	105,608	2,031	105,898	158	46,468	2	5,161	32,700	518,043
Oudh . . .	7,159	76,567	1,475	28,643	998	41,889	434	57,398	386	97,572	10,452	302,069
British Burma .	7,505	56,897	1,191	19,525	569	25,208	279	23,249	10	24,591	9,554	149,470
C.P.	8,035	80,290	2,578	53,285	1,415	77,103	154	41,246	7	15,553	12,189	267,477
	370,428	3,272,247	95,608	1,533,562	48,380	2,250,658	6,242	1,736,362	836	1,409,635	521,494	10,202,462

APPENDIX E

STATEMENT SHOWING NUMBER OF INCOME-TAX ASSESSEES AND THE AMOUNT OF ASSESSMENT, 1900–1 TO 1915–16

	Years.	Original No. of Assessees.	Final No. of Assessees.	Petitions and Objections.	Original Demand. Rs.	Final Demand. Rs.
Bengal	1900–1	121,128	116,720	11,250	4,888,591	4,657,149
	1905–6	42,648	40,875	5,994	4,275,166	3,867,133
	1910–11	49,578	48,837	6,031	5,040,538	4,966,362
	1915–16	54,878	54,176	4,056	6,552,140	6,481,642
North-West Province	1900–1	71,085	68,696	6,101	2,262,428	2,143,368
	1905–6	29,620	28,556	2,510	1,785,979	1,722,334
	1910–11	32,095	31,153	2,632	2,027,927	1,948,894
	1915–16	36,187	35,288	2,739	2,392 335	2,319,667
Bombay	1900–1	86,806	82,312	20,101	4,264,561	3,335,849
	1905–6	44,377	42,632	10,163	3,466,872	3,312,171
	1910–11	51,220	48,997	13,552	4,939,251	4,568,520
	1915–16	68,056	65,082	17,678	7,789,070	6,769,756
Madras	1900–1	86,794	84,047	28,780	2,535,946	2,430,888
	1905–6	41,482	40,258	13,283	2,442,592	2,333,432
	1910–11	47,702	46,585(*a*)	12,644	2,858,788(*b*)	2,740,284(*b*)
	1915–16	56,541	55,245(*a*)	15,381	3,591,473(*b*)	3,472,679(*b*)

(*a*) These figures do not include Government servants and holders of securities.

N.B.—The number of petitions and objections include those before the Collector as well as the Commissioner.

(*b*) The figures are exclusive of the tax realized from salaries of Government servants and also from interest on Government securities.

APPENDIX F

RECEIPTS FROM SUPER-TAX DURING 1922–3 TO 1926–7

Year.	Collections from Individuals.		Collections from Companies.		Collections from Unregistered Firms.		Collections from Joint Hindu Families.		TOTAL.	
	No.	Amount in Rs.	No.	Amount in Rs.	No.	Amount in Rs.	No.	Amount in Rs.	No.	Amount in Rs.
1922–3 . . .	1,345	22,889,810	854	36,195,564	445	6,119,069	300	5,879,374	2,944	71,083,817
1923–4 . . .	1,546	21,820,473	944	32,691,414	422	3,680,814	264	3,058,540	3,176	61,251,241
1924–5 . . .	1,527	16,347,410	908	26,295,667	381	3,195,359	277	2,462,398	3,093	48,300,834
1925–6 . . .	1,380	14,727,440	889	27,563,337	409	2,881,648	278	1,962,223	2,956	47,134,648
1926–7 . . .	1,521	16,688,865	848	25,572,468	389	3,155,212	251	1,898,122	3,009	47,314,667

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